Section 8

General Explanation of the
Tax Reform Act of 1986

[JOINT COMMITTEE PRINT]

GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986

(H.R. 3838, 99TH CONGRESS; PUBLIC LAW 99-514)

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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Property that qualifies for transitional relief from the amendments relating to the rehabilitation tax credit is also excepted from the depreciation changes made by section 201 of the Act.

Revenue Effect

This provision is estimated to increase fiscal year budget receipts by $43 million in 1987, $165 million in 1988, $581 million in 1989, $1,371 million in 1990, and $1,779 million in 1991.

2. Tax credit for low-income rental housing (sec. 252 of the Act and sec. 42 of the Code)[1]

Prior Law

No low-income rental housing tax credit was provided under prior law, but other tax incentives for low-income housing were available. These tax incentives consisted principally of special accelerated depreciation, five-year amortization of rehabilitation expenses, expensing of construction period interest and taxes, and tax-exempt bond financing for multifamily residential rental property.

Reasons for Change

Congress was concerned that the tax preferences for low-income rental housing available under prior law were not effective in providing affordable housing for low-income individuals. Congress believed a more efficient mechanism for encouraging the production of low-income rental housing could be provided through the low-income rental housing tax credit.

The primary tax preferences provided for low-income housing under prior law were tax-exempt bond financing, accelerated cost recovery deductions, five-year amortization of rehabilitation expenditures, and special deductions for construction period interest and taxes. These preferences operated in an uncoordinated manner, resulted in subsidies unrelated to the number of low-income individuals served, and failed to guarantee that affordable housing would be provided to the most needy low-income individuals.

A major shortcoming of the prior-law tax subsidies was that, beyond a minimum threshold requirement of low-income housing units that were required to be served, the degree of subsidy was not directly linked to the number of units serving low-income persons. As a result, there was no incentive to provide low-income units beyond the minimum required. Under the tax credit, however, the amount of the low-income housing tax credit which an owner may receive is directly related to the number of rental units made available to low-income individuals. By providing tax credits which are based on the number of units serving low-income persons, an incen-

[1] For legislative background of the provision, see: H.R. 3838, as reported by the Senate Committee on Finance on May 29, 1986, sec. 1413; S.Rep. 99-313, pp. 757-768; Senate floor amendment, 132 Cong. Rec. S8146-8158 (June 23, 1986); and H.Rep. 99-841, Vol. II (September 18, 1986), pp. 85-103 (Conference Report).

tive exists to provide a greater number of housing units for more low-income individuals.

Another weakness of the Federal tax subsidies available under prior law was that they were not targeted to persons of truly low-income. For example, a study by the General Accounting Office[2] (GAO) of tax-exempt bond financed residential rental projects found that above-average income renters could qualify under prior law as "low" or "moderate" income for two reasons. First, persons with incomes as high as 80 percent of area median income were eligible to occupy units reserved for low- and moderate-income tenants. This income ceiling was relatively high, particularly when compared with the median income of renters. Second, the Treasury Department did not require household incomes to be adjusted for family size until after 1985. Congress believed that the low-income housing tax credit (as well as tax-exempt bond financing for low-income housing, discussed in Title XIII) should be provided only for households with incomes not exceeding 50 percent or 60 percent of area median income. Congress further believed that these income limits should be adjusted for family size. These provisions better target affordable housing to those persons most in need of assistance.

Another shortcoming of the tax subsidies under prior law was that none limited the rents that could be charged to low-income individuals. The same GAO study found, for example, that while 96 percent of individuals with incomes over 80 percent of area median income (the prior-law ceiling on "low" or "moderate" income) paid rents of less than 30 percent of their income, only 37 percent of individuals with incomes below 80 percent of area median paid rents of less than 30 percent of their income. The low-income housing tax credit limits the rent that may be charged to a low-income tenant, and therefore ensures that the subsidized housing is affordable to low-income individuals. In return for providing housing at reduced rents, owners of rental housing receive a tax credit designed to compensate them for the rent reduction.

Congress believed that the low-income housing tax credit (and tax-exempt bonds, as retargeted) will more effectively serve both low-income individuals and owners willing to provide affordable low-income housing than the multiple, uncoordinated tax preferences for low-income housing under prior law.

Explanation of Provisions

Overview

The Act provides a tax credit that may be claimed by owners of residential rental property used for low-income housing. The credit is claimed annually, generally for a period of ten years. New construction and rehabilitation expenditures for low-income housing projects placed in service in 1987 are eligible for a maximum nine percent credit, paid annually for ten years. The acquisition cost of existing projects and the cost of newly constructed projects receiv-

[2] United States General Accounting Office, *Report to the Chairman, Joint Committee on Taxation, Rental Housing: Costs and Benefits of Financing with Tax-Exempt Bonds* (GAO/RCED-86-2), February 1986.

ing other Federal subsidies placed in service in 1987 are eligible for a maximum four percent credit, also paid annually for ten years. For buildings placed in service after 1987, these credit percentages will be adjusted to maintain a present value of 70 percent and 30 percent for the two types of credits.

The credit amount is based on the qualified basis (defined below) of the housing units serving the low-income tenants. Low-income tenants for purposes of the low-income housing tax credit are defined as tenants having incomes equal to or less than either 50 percent or 60 percent of area median income, adjusted for family size. The qualifying income for a particular property depends on the minimum percentage of units that the owner elects to provide for low-income tenants. Rents that may be charged families in units on which a credit is claimed may not exceed 30 percent of the applicable income qualifying as "low", also adjusted for family size.

To qualify for the credit, residential rental property must comply continuously with all requirements of the credit throughout a 15-year compliance period. A credit allocation from the appropriate State or local credit authority must be received by the owner of property eligible for the low-income housing tax credit, unless the property is substantially financed with the proceeds of tax-exempt bonds subject to the new private activity bond volume limitation. These provisions are further explained in the following sections.

Credit amount and credit period

The Act provides two separate credit amounts: (1) a 70-percent present value credit for qualified new construction and rehabilitation expenditures (in excess of specified minimum amounts per unit) that are not federally subsidized and (2) a 30-percent present value credit for other qualifying expenditures. Expenditures qualifying for the 30-percent present value credit consist of the cost of acquisition of an existing building (including certain rehabilitation expenditures which are incurred in connection with acquisition and which do not exceed prescribed minimum amounts), and federally subsidized new construction or rehabilitation expenditures.

A taxpayer's credit amount in any taxable year is computed by applying the appropriate credit percentage to the appropriate qualified basis amount in such year, as defined below.[3] Except as described below, both credits are claimed annually over a 10-year period.

The credit period is the 10-year 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. The credit may not be claimed for a taxable year in which the building is not in compliance with all requirements of the credit.

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[3] Congress understood that in certain cases low-income rental housing tax credit projects would be owned indirectly through partnerships. Congress intended that Treasury Department regulations will include rules treating partnerships as if they were taxpayers where appropriate to carry out the objectives of the tax credit. Congress intended, for example, that the partnership be treated as the taxpayer for purposes of determining whether a building is new (sec. 42(i)(4)). Where a partner's interest changes during a taxable year, it is intended that each partner's distributive share of the tax credit be determined under general partnership allocation rules (*see* sec. 706), i.e., by the use of a method prescribed in Treasury Department regulations that takes into account the varying interests of the partners in the partnership during such taxable year.

Credit percentage

For buildings placed in service in 1987, the credit percentages are 9 percent annually over 10 years for the 70-percent present value credit, and 4 percent annually over 10 years for the 30-percent present value credit.

For buildings placed in service after 1987, these credit percentages are to be adjusted monthly by the Treasury Department to reflect the present values of 70 percent and 30 percent at the time the building is placed in service. Treasury's monthly adjustments of the credit percentages are to be determined on a discounted after-tax basis, based on the average of the annual applicable Federal rates (AFR) for mid-term and long-term obligations for the month the building is placed in service. The after-tax interest rate is to be computed as the product of (1) the average AFR and (2) .72 (one minus the maximum individual Federal income tax rate). The discounting formula assumes each credit is received on the last day of each year and that the present value is computed as of the last day of the first year. For example, if 72 percent of the average AFR for a given month were 5.85 percent, the 70-percent and 30-percent present value credit percentages for buildings placed in service in that month would be 8.92 percent and 3.82 percent. (For the 70-percent present value credit, this is derived as $.0892 = (.70)(.0585)/[1.0585\text{-}1/(1.0585)^9]$.) In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.[4]

For buildings originally placed in service after 1987, Congress intended that the taxpayer, with the consent of the housing credit agency, may irrevocably elect to use the credit percentage determined using the above method for the month in which the taxpayer receives a binding commitment for a credit allocation from the credit agency or, in the case of a tax-exempt bond financed project for which no allocation is required, the month in which the tax-exempt bonds are issued.[5]

The credit percentage for rehabilitation expenditures (in excess of a prescribed minimum amount) is determined when rehabilitation is completed and the rehabilitated property is placed in service, but no later than the end of the 24-month period for which such expenditures may be aggregated.[6] These rehabilitation expenditures are treated as a separate new building for purposes of the credit.

The credit percentage for rehabilitation expenditures that are incurred in connection with the acquisition of an existing building (and which do not exceed prescribed minimum amounts) is the same percentage as is used for the acquired building, i.e., the per-

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[4] As discussed below, a credit percentage equal to two-thirds of the credit percentage for the initial qualified basis is applicable to additions to qualified basis.

[5] A technical amendment may be needed so that the statute reflects this intent and the intent of Congress that such an election would be binding on the taxpayer and all successors in interest.

[6] Congress intended that the election to determine the credit percentage at the time a binding commitment for a credit allocation is received, described above, also apply in the case of credits attributable to rehabilitation expenditures (in excess of a prescribed minimum amount). A technical amendment may be needed so that the statute reflects this intent.

centage determined when the acquired building is placed in service.

Qualified basis

In general

The qualified basis amounts with respect to which the credit amount is computed are determined as the proportion of eligible basis in a qualified low-income building attributable to the low-income rental units. This proportion is the lesser of (1) the proportion of low-income units to all residential rental units or (2) the proportion of floor space of the low-income units to the floor space of all residential rental units. Generally, in these calculations, low-income units are those units presently occupied by qualifying tenants, whereas residential rental units are all housing units, whether or not presently occupied.

The qualified basis for each building is determined on the last day of each taxable year, beginning in the taxable year in which the building is placed in service or, if the taxpayer elects, the following taxable year.

Special rules for determining qualified basis

The Treasury Department may provide regulations for projects consisting of two or more buildings. Unless prescribed in regulations, the qualified basis of a project consisting of two or more buildings is determined separately for each building. Common facilities in such a project must be allocated in an appropriate manner to all buildings (whether existing or to be constructed) in the project.

The first year the credit is claimed, the allowable credit amount is determined using an averaging convention to reflect the number of months units comprising the qualified basis were occupied by low-income individuals during the year. For example, if half of the low-income units included in qualified basis were first occupied in October and the remaining half were occupied in December, a calendar year taxpayer would adjust the allowable first-year credit to reflect that these units were occupied on average only one-sixth of the year. To the extent there is such a reduction of the credit amount in the first year, an additional credit in the amount of such reduction is available in the eleventh taxable year. (This first-year adjustment does not affect the amount of qualified basis with respect to which the credit is claimed in subsequent years of the 10-year credit period.)

Additions to qualified basis

The qualified basis of a building may be increased subsequent to the initial determination only by reason of an increase in the number of low-income units or in the floor space of the low-income units (as opposed to by reason of increases in the eligible basis). Credits claimed on such additional qualified basis are determined using a credit percentage equal to two-thirds of the applicable credit percentage allowable for the initial qualified basis. As described below under the description of the State credit ceiling, an allocation of credit authority must be received for credits claimed

on additions to qualified basis, in the same manner as for credits claimed on the initial qualified basis. Unlike credits claimed on the initial qualified basis, credits claimed on additions to qualified basis are allowable annually for the portion of the required 15-year compliance period remaining after eligibility for such credits arises, regardless of the year such additional qualified basis is determined. The additional qualified basis is determined by reference to the original adjusted basis (before deductions for depreciation) of the property.

The credit amount on the additional qualified basis is adjusted in the first year such additions are made using an averaging convention to reflect the number of months units comprising the additional qualified basis were occupied by low-income individuals during the year. Any reduction of the credit amount in the first year may not be claimed in a later year. (This first-year adjustment does not affect the amount of additional qualified basis with respect to which the credit is claimed in subsequent years of the compliance period.)

Eligible basis

Eligible basis consists of (1) the cost of new construction, (2) the cost of rehabilitation, or (3) the cost of acquisition of existing buildings acquired by purchase (including the cost of rehabilitation, if any, to such buildings incurred before the close of the first taxable year of the credit period which do not exceed a prescribed minimum amount). Only the adjusted basis of the depreciable property may be included in eligible basis.[7] The cost of land is not included in adjusted basis.

Generally, the eligible basis of a building is determined at the time the building is placed in service. For this purpose, rehabilitation expenditures (in excess of $2,000 per unit) are treated as placed in service at the close of the period for which rehabilitation expenditures are aggregated, not to exceed 24 months. In the case of rehabilitation expenditures incurred in connection with the acquisition of an existing building (and which do not exceed a prescribed minimum amount), the capital expenditures incurred through the end of the first year of the credit period may be included in eligible basis.

For purposes of the low-income housing credit, the term residential rental property generally has the same meaning as residential rental property within Code section 142(d).[8] Thus, residential rental property includes residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project. Eligible basis may include the cost of such facilities and amenities (e.g., stoves, refrigerators, air conditioning units, etc.) only if the included amenities are comparable to the cost of the amenities in the low-income units. Additionally, the allocable cost of tenant facilities, such as swimming pools, other recreational fa-

[7] The adjusted basis is determined by taking into account the adjustments described in section 1016 (other than paragraphs (2) and (3) of sec. 1016(a), relating to depreciation deductions), including, for example, the basis adjustment provided in section 48(q) for any rehabilitation credits allowed under section 38.

[8] See, however, the discussion below on single room occupancy housing as property eligible for the low-income housing credit.

cilities, and parking areas, may be included provided there is no separate fee for the use of these facilities and they are made available on a comparable basis to all tenants in the project. (*See generally*, Treas. Reg. sec. 1.103-8(b)(4)(iii).)

Except as described below, costs of the residential rental units in a building which are not low-income units may be included in eligible basis only if such units are not above the average quality standard of the low-income units. Similarly, rehabilitation expenditures may not be included in eligible basis if such expenditures improve any unit in the building beyond comparability with the low-income units. Units are of comparable quality if the construction or acquisition costs are comparable and if such units are provided in a similar proportion for both the low-income and other tenants. Congress intended that, at the election of the taxpayer, the cost of a unit which would otherwise be excluded from eligible basis may be included in eligible basis if (1) the excess cost of such unit over the average cost of the low-income units does not exceed 15 percent of the average cost of the low-income units and (2) the excess cost is excluded from eligible basis.[9]

Residential rental property may qualify for the credit even though a portion of the building in which the residential rental units are located is used for a commercial use. No portion of the cost of such nonresidential rental property included in a project may be included in eligible basis. Congress intended that the costs of such a mixed-use facility be allocated according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the nonresidential rental property and the residential rental units. (*See*, e.g., Prop. Treas. Reg. sec. 1.103-8(b)(4)(v).)

Certain rehabilitation expenditures.—The qualified basis attributable to rehabilitation expenditures, unless incurred in connection with the acquisition of an existing building, must equal at least $2,000 per low-income unit.[10] The $2,000 minimum is computed as an average based on all qualifying expenditures in the building, rather than on a unit-by-unit determination. Qualified basis is determined in the same fractional manner as for new construction or acquisition costs even if all rehabilitation expenditures are made only to low-income units. Rehabilitation expenditures may be included in eligible basis without a transfer of property. Rehabilitation expenditures may be aggregated only for such expenditures incurred during any 24-month period. Where rehabilitation is limited to a group of units, Treasury may provide regulations treating a group of units as a separate new building.

Where rehabilitation expenditures are paid or incurred by a person (or persons) and the taxpayer acquires the property attributable to such expenditures (or an interest therein) before such property is placed in service, the taxpayer will be treated as having paid or incurred the expenditures (*see* Treas. Reg. sec. 1.167(k)-1(b)(1) and (2)). The portion of the basis of the property not attributable to rehabilitation expenditures may not be included in the eli-

[9] A technical amendment may be needed so that the statute reflects this intent.

[10] See, below, in the case of rehabilitation expenditures incurred in connection with the acquisition of an existing building that do not exceed the $2,000 per unit minimium.

gible basis relating to the rehabilitated property, but may be includable in the eligible basis relating to acquisition costs, as described below.

Acquisition of existing buildings.—The cost of acquisition of an existing building may be included in eligible basis and any rehabilitation expenditures to such a building incurred before the close of the first year of the credit period may at the election of the taxpayer also be included in eligible basis, without a minimum rehabilitation requirement. These costs may be included in eligible basis, however, only if the building or a substantial improvement (a capital expenditure of 25 percent or more of the adjusted basis of the building to which five-year rapid amortization was elected or to which ACRS applied (as in effect before the enactment of this Act)) to the building has not been previously placed in service within 10 years and if the building (or rehabilitated property within the building) is not subject to the 15-year compliance period.

A building that is transferred in a transfer where the basis of the property in the hands of the new owner is determined in whole or part by the adjusted basis of the previous owner (for example, by a gift of property) is considered not to have been newly placed in service for purposes of the 10-year requirement.[11] Further, Congress intended that a building which has been acquired by a governmental unit or certain qualified 501(c)(3) or 501(c)(4) organizations would not be treated as placed in service by that governmental unit or organization for purposes of the 10-year requirement if the acquisition occurs more than 10 years from the date the building or a substantial improvement to the building has last been placed in service.[12] Congress also intended that a building acquired by foreclosure by taxpayers other than a governmental unit or 501(c)(3) organization would not be treated as newly placed in service by that taxpayer for purposes of the 10-year requirement if the foreclosure occurs more than 10 years from the date the building or a substantial improvement to the building has last been placed in service and the property is resold within a short period.[13] Any other transfer will begin a new 10-year period.

The Treasury Department may waive the 10-year requirement for any building substantially assisted, financed or operated under the HUD section 8, section 221(d)(3), or section 236 programs, or under the Farmers' Home Administration section 515 program when an assignment of the mortgage secured by property in the project to HUD or the Farmers Home Administration otherwise would occur or when a claim against a Federal mortgage insurance fund would occur.

Federal grants and other subsidies.—Eligible basis may not include in any taxable year the amount of any Federal grant, regardless of whether such grant is included in gross income. A Federal grant includes any grant funded in whole or in part by the Federal government, to the extent funded with Federal funds. Examples of grants which may not be included in eligible basis include grants

[11] Congress intended that inherited property not be treated as being newly placed in service for purposes of the 10-year requirement. A technical amendment may be needed so that the statute reflects this intent.

[12] A technical amendment may be needed so that the statute reflects this intent.

[13] A technical amendment may be needed so that the statute reflects this intent.

funded by Community Development Block Grants, Urban Development Action Grants, Rental Rehabilitation Grants, and Housing Development Grants.

If any portion of the eligible basis attributable to new construction or to rehabilitation expenditures is financed with Federal subsidies, the qualified basis is eligible only for the 30-percent present value credit, unless such Federal subsidies are excluded from eligible basis. A Federal subsidy is defined as any obligation the interest on which is exempt from tax under section 103 or a direct or indirect Federal loan, if the interest rate on such loan is less than the applicable Federal rate. A Federal loan under the Farmers' Home Administration section 515 program is an example of such a Federal subsidy, as is a reduced interest rate loan attributable in part to Federal grant funds lent to a building owner.

The determination of whether rehabilitation expenditures are federally subsidized is made without regard to the source of financing for the construction or acquisition of the building to which the rehabilitation expenditures are made. For example, a Federal loan or tax-exempt bond financing that is continued or assumed upon purchase of existing housing is disregarded for purposes of the credit on rehabilitation expenditures. Congress intended that tax-exempt financing or a below market loan to provide construction financing for any building will not be treated as a Federal subsidy if such loan is repaid and any underlying obligation (e.g., tax-exempt bond) is redeemed before the building is placed in service.[14]

Minimum set-aside requirement for low-income individuals

In general

A residential rental project providing low-income housing qualifies for the credit only if (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 50 percent or less of area median income, as adjusted for family size, or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of area median income, as adjusted for family size.[15] (This requirement is referred to as the "minimum set-aside" requirement.)

A special set-aside may be elected for projects that satisfy a stricter requirement and that significantly restrict the rents on the low-income units relative to the other residential units in the building (the "deep-rent skewing" set-aside). Projects qualify for this rule only if, as part of the general set-aside requirement, 15 percent or more of all low-income units are occupied by individuals having incomes of 40 percent (rather than 50 percent or 60 percent) or less of area median income, and the average rent charged to tenants in the residential rental units which are not low-income units is at least 300 percent of the average rent charged to low-income tenants for comparable units. Under this special rule, a low-income

[14] A technical amendment may be needed so that the statute reflects this intent.

[15] A special set-aside requirement providing that 25 percent or more of the units are occupied by individuals with incomes of 60 percent or less of area median income is provided for New York City (*see* sec. 142(d)(6)).

tenant will continue to qualify as such, as long as the tenant's income does not exceed 170 percent of the qualifying income. Additionally, if a project to which this special set-aside requirement applies ceases to comply with the requirement because of increases in existing tenants' incomes, no penalties are imposed if each available low-income unit is rented to tenants having incomes of 40 percent or less of area median income, until the project is again in compliance.[16]

All units comprising the minimum set-aside in a project must be suitable for occupancy and used on a nontransient basis, and are subject to the limitation on gross rent charged to residents of set-aside units. (See the discussion of the gross rent limitation, below.)

The owner of each project must irrevocably elect the minimum set-aside requirement (including the deep-rent skewing set-aside described above) at the time the project is placed in service. In the case of a project consisting of a single building, the set-aside requirement must be met within 12 months of the date the building (or rehabilitated property) is placed in service, and complied with continuously thereafter for a period ending 15 years after the first day of the first taxable year in which the credit is claimed.

Special rules apply to projects consisting of multiple buildings placed in service on different dates. Unless prescribed by regulations, the initial building, within 12 months of being placed in service, must meet the set-aside requirement determined only by reference to those units in the initial building. When a second or subsequent building is placed in service, the project must meet the set-aside requirement with respect to the units in all buildings placed-in-service up to that time within 12 months of the date the second or subsequent building is placed in service.[17] The project must comply with this expanded requirement continuously thereafter for a period ending 15 years after the later of (1) the first day of the taxable year in which the expanded requirement is met or (2) if a credit is claimed with respect to the building, the first day of the taxable year in which the credit period begins with such building.[18] Subsequent buildings are subject to separate 15-year compliance periods. After the 15-year period has expired on an initial building, but while other buildings in the same project are still subject to the compliance period, the project must continue to meet the set-aside requirement determined by reference to all buildings in the project or, at the taxpayer's election, all buildings subject to the compliance period.

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[16] Congress intended that for projects electing this stricter set-aside requirement the definition of gross rent is that used generally for purposes of the low-income credit. A technical amendment may be needed so that the statute reflects this intent.

[17] Congress intended that if within 12 months of the date a first building is placed in service, (1) the first building does not meet the set-aside requirement with respect to the first building and (2) a second building is placed in service, then the project is a qualified low-income project if the set-aside requirement is satisfied with respect to both buildings within 12 months of the placed-in-service date of the first building. A technical amendment may be needed so that the statute reflects this intent. Congress intended that similar rules apply by Treasury Department regulations in the case of projects with more than two buildings.

[18] Until the expanded requirement is met, the set-aside requirements determined by reference to all previously existing buildings must be continuously satisfied.

Continuous compliance required

The determination of whether a tenant qualifies for purposes of the low-income set-aside is made on a continuing basis, both with regard to the tenant's income and the qualifying area income, rather than only on the date the tenant initially occupies the unit. An increase in a tenant's income may result, therefore, in a unit ceasing to qualify as occupied by a low-income person. However, a qualified low-income tenant is treated as continuing to be such notwithstanding *de minimis* increases in his or her income. Under this rule, a tenant qualifying when initially occupying a rental unit will be treated as continuing to have such an income provided his or her income does not increase to a level more than 40 percent in excess of the maximum qualifying income, adjusted for family size. If the tenant's income increases to a level more than 40 percent above the otherwise applicable ceiling (or if the tenant's family size decreases so that a lower maximum family income applies to the tenant) that tenant is no longer counted in determining whether the project satisfies the set-aside requirement.[19] No penalty is assessed in such an event, however, provided that each residential rental unit that becomes vacant (of comparable or smaller size to the units no longer satisfying the applicable income requirement) is rented to tenants satisfying the qualifying income until the project is again in compliance. (For a discussion of the rules for complying with the set-aside requirements, see the discussion of the compliance period and penalty for noncompliance, below.)

Vacant units, formerly occupied by low-income individuals, may continue to be treated as occupied by a qualified low-income individual for purposes of the set-aside requirement (as well as for determining qualified basis) provided reasonable attempts are made to rent the unit and no other units of comparable or smaller size in the project are rented to nonqualifying individuals (see the section "Compliance period and penalty for noncompliance," below).

In no case is a unit considered to be occupied by low-income individuals if all of the occupants of such unit are students (as determined under sec. 151(c)(4)), no one of whom is entitled to file a joint income tax return.

Adjustments for family size

As stated above, the Act requires that adjustments for family size be made in determining the incomes used to qualify tenants as having low income. In general, these adjustments are the same as the adjustments presently made under section 8 of the United States Housing Act of 1937. Thus, for a project which qualifies by setting aside 20 percent of the units for tenants having incomes of 50 percent or less of area median income, a family of four generally will be treated as meeting this standard if the family has an income of 50 percent or less of the area median income; a family of three having an income of 45 percent or less generally will qualify; a family of two having an income of 40 percent or less generally

[19] In the case of projects electing the deep-rent skewing set-aside, a tenant's income may increase to 70 percent more than the maximum qualifying income.

will qualify; and, a single individual having an income of 35 percent or less generally will qualify.

Congress was aware that, in certain cases, the use of section 8 guidelines may result in qualifying incomes below the amounts reflected by these percentages because of dollar ceilings that are applied under the section 8 program. Income limits may be adjusted by the Treasury Department for areas with unusually low family income or high housing costs relative to family income in a manner consistent with determinations of very low income families and area median gross income under section 8 to reflect the 50-percent and 60-percent income levels.

Gross rent limitation

The gross rent paid by families in units included in qualified basis may not exceed 30 percent of the applicable qualifying income, adjusted for family size. Gross rent includes the cost of any utilities, other than telephone. If any utilities are paid directly by the tenant, the maximum rent that may be paid by the tenant is to be reduced by a utility allowance prescribed by the Treasury Department, after taking into consideration the procedures for making such adjustments under section 8 of the United States Housing Act of 1937.

The gross rent limitation applies only to payments made directly by the tenant. Any rental assistance payments made on behalf of the tenant, such as through section 8 of the United States Housing Act of 1937 or any comparable Federal rental assistance, are not included in gross rent. Congress further intended that any comparable State or local government rental assistance not be included in gross rent.[20]

Low-income unit

A low-income unit includes any unit in a qualified low-income building if the individuals occupying such unit meet the income limitation elected for the project for purposes of the minimum set-aside requirement and if the unit meets the gross rent requirement, as well as meeting all other requirements applicable to units satisfying the minimum set-aside requirement.

Qualified low-income housing projects and qualified low-income buildings

A qualified low-income building is a building subject to the 15-year compliance period and which is part of a qualified low-income housing project.

A qualified low-income housing project is a project that meets the minimum set-aside requirement and other requirements with respect to the set-aside units at all times that buildings comprising the project are subject to the 15-year compliance period. A qualified low-income housing project includes a qualified low-income building containing residential rental units and other property that is functionally related and subordinate to the function of providing

[20] A technical amendment may be needed so that the statute reflects this intent. Such an amendment was included in the versions of H. Con. Res. 395 which passed the House of Representatives and Senate in the 99th Congress.

residential rental units. A project may include multiple buildings having similarly constructed housing units, provided the buildings are located on the same tract of land, are owned by the same person for Federal income tax purposes, and are financed pursuant to a common plan of financing.

Residential rental units must be for use by the general public and all of the units in a project must be used on a nontransient basis. Residential rental units are not for use by the general public, for example, if the units are provided only for members of a social organization or provided by an employer for its employees. Generally, a unit is considered to be used on a nontransient basis if the initial lease term is six months or greater. Additionally, no hospital, nursing home, sanitarium, lifecare facility, retirement home providing significant services other than housing, dormitory, or trailer park may be a qualified low-income project. Factory-made housing which is permanently fixed to real property may be a qualified low-income building (see Treas. Reg. sec. 6a.103A-2(d)(4)(i) on factory-made housing).

Unlike the requirements for units in projects financed with tax-exempt bonds, certain single room occupancy housing used on a nontransient basis may qualify for the credit, even though such housing may provide eating, cooking, and sanitation facilities on a shared basis. An example of housing that may qualify for the credit is a residential hotel used on a nontransient basis that is available to all members of the public.

Compliance period and penalty for noncompliance

Qualified residential rental projects must remain as rental property and must satisfy the minimum set-aside requirement, described above, throughout a prescribed compliance period. Low-income units comprising the qualified basis on which additional credits are based are required to comply continuously with all requirements in the same manner as units satisfying the minimum set-aside requirement. Units in addition to those meeting the minimum set-aside requirement on which a credit is allowable also must continuously comply with this requirement.

The Act defines the compliance period for any building as the period beginning on the first day of the first taxable year of the credit period of such building and ending 15 years from such date. The minimum set-aside requirement must be met, in all cases, within 1 year of the date the building (or rehabilitated property) is placed in service.

Within 90 days of the end of the first taxable year for which the credit is claimed and annually for each taxable year thereafter during the compliance period, the taxpayer must certify to the Secretary that the project has continuously complied throughout the year with the set-aside requirement and report the dollar amount of the qualified basis of the building and the maximum applicable percentage and qualified basis permitted to be taken into account by the housing credit agency. Additionally, the certification must include the date (including the taxable year) in which the building

was placed in service and any other information required by Treasury.[21]

The penalty for any building subject to the 15-year compliance period failing to remain part of a qualified low-income project (due, for example, to noncompliance with the minimum set-aside requirement or the gross rent requirement or other requirements with respect to the units comprising the set-aside) is recapture of the accelerated portion of the credit, with interest, for all prior years.

Generally, any change in ownership by a taxpayer of a building subject to the compliance period is also a recapture event. An exception is provided if the seller posts a bond with the Treasury Department (in an amount prescribed by Treasury) and provided it can reasonably be expected that such building will continue to be operated as a qualified low-income building for the remainder of the compliance period. For partnerships consisting of more than 35 individual taxpayers, at the partnership's election, no change in ownership will be deemed to occur provided within a 12-month period at least 50 percent (in value) of the original ownership is unchanged.[22]

In the year of a recapture event, no credit is allowable for the taxpayer subject to recapture. Additionally, the accelerated portion of credits paid in earlier years is recaptured with interest, from the date the recaptured amount was claimed, at the overpayment rate established under section 6621. The accelerated portion of the credit in any year is the amount of credits determined for the year, less the amount which would have been determined for the year if all credits had been allowed ratably over the 15-year compliance period (with no further discounting). Because credits on the initial qualified basis of a building are claimed ratably over a 10-year credit period rather than the 15-year compliance period, the amount of credit recaptured for noncompliance during the first 11 years is one-third of the credit determined for the year, plus interest. In the absence of additions to qualified basis and previous recapture events, the credits are recaptured in the following amounts (in addition to interest): one-third for violations after year 1 and before expiration of year 11; four-fifteenths for violations after year 11 but before expiration of year 12; three-fifteenths for violations after year 12 but before expiration of year 13; two-fifteenths for violations after year 13 but before expiration of year 14; and one-fifteenth for violations after year 14 but before expiration of year 15.

Because credits claimed on additions to qualified basis are paid ratably over the remainder of the compliance period (the credit percentage is two-thirds of the otherwise applicable percentage), there is no accelerated portion of credits attributable to additions to qualified basis and, therefore, no recapture of these amounts.

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[21] Congress intended that the penalty under sec. 6652(j) shall apply for failure to provide such information. A technical amendment may be needed so that the statute reflects this intent.

[22] Congress intended that the presence of corporate partners not disqualify the partnership from this special exception provided the partnership is at least 50 percent owned by at least 35 individual taxpayers. A technical amendment may be needed so that the statute reflects this intent.

The penalty for a decrease in the qualified basis of a building, while still remaining part of a qualified low-income project, is recapture of the credits with respect to the accelerated amount claimed for all previous years on the amount of the reduction in qualified basis.

Owners and operators of low-income housing projects on which a credit has been claimed must correct any noncompliance with the set-aside requirement or with a reduction in qualified basis within a reasonable period after the noncompliance is discovered or reasonably should have been discovered. If any noncompliance is corrected within a reasonable period, there is no recapture. Congress did not intend, however, that tenants be evicted to return a project to compliance. Rather, Congress intended that each residential rental unit of comparable or smaller size that becomes vacant while a project is not in compliance must be rented to a tenant having a qualifying income before any units in the project are rented to tenants not so qualifying until the project again is in compliance. In general, therefore, the event that gives rise to the penalty for noncompliance (i.e., recapture or a reduction in the allowable credit) will be rental of a unit to other than a low-income tenant (on other than a temporary basis) during any period when the project does not comply with the set-aside requirement or with the qualified basis amounts on which the credit is computed (or would not qualify as a result of that rental).

An example of how the recapture provisions operate follows:

Example.— Assume credits are claimed for a project based on a qualified basis of 30 percent of the basis of the project being allocable to units occupied by individuals with incomes of 50 percent or less of area median income and, at a later date, a qualified basis of only 25 percent of the basis of the project is allocable to units occupied by individuals with incomes of 50 percent or less of median income due to vacancies filled by tenants with nonqualifying incomes. Because the minimum set-aside requirement is not violated, recapture occurs only on the accelerated portion of the credit amounts allocable to the 5-percent basis of the project no longer eligible for the credit.

If the maximum credit for which a project is eligible increases and subsequently decreases, a last-in, first-out rule is applied in determining which credits are recaptured. For example, consider a building that initially claimed a credit based on a qualified basis of 25 percent of the basis of the building allocable to units occupied by individuals with incomes of 50 percent or less of area median income, and in year 3 began receiving a credit based on an additional 10 percent of the basis of the building (i.e., a total of 35 percent). The credit amount on the additions to qualified basis is computed by reference to two-thirds of the credit percentage. If in year 5 only 30 percent of the basis of the building qualifies, there is no recapture of previous years' credits because there is no accelerated portion of the credit amounts attributable to the 5 percent of the additions to qualified basis claimed since year 3.

Congress intended that there be no recapture for *de minimis* changes in the qualified basis by reason of changes in the floor

space fraction.[23] A reduction in qualified basis by reason of a casualty loss is not a recapture event provided such property is restored by reconstruction or replacement within a reasonable period.

State low-income housing credit authority limitation

Generally, any building eligible for the credit must receive an allocation of credit authority from the State or local credit agency in whose jurisdiction the qualifying low-income housing project is located. (An exception is provided for buildings financed with the proceeds of tax-exempt bonds that received an allocation pursuant to the new private activity bond volume limitation.) The aggregate amount of such credits allocated within the State is limited by the State annual low-income credit authority limitation. In all cases, credit allocations are counted against a State's annual credit authority limitation for the calendar year in which the credits are allocated. Congress intended that credits may be allocated only during the calendar year in which the building or rehabilitated property is placed in service, except in the case of (1) credits claimed on additions to qualified basis and (2) credits allocated in a later year pursuant to an earlier binding commitment made no later than the year in which the building is placed in service.[24] Under this latter exception, for example, a building placed in service in 1987 may receive a binding commitment in 1987 to receive a credit allocation of a specified amount in 1989. In 1989 this amount is subtracted from the State credit authority limitation. The credit period and compliance period with respect to the building begin in the taxable year in which the building is placed in service or, by an irrevocable election of the taxpayer, the succeeding taxable year.

An election by the taxpayer to defer the start of the credit period for one year does not affect when the allocation must occur. (See also, the discussion below for credits claimed on additions to qualified basis). The credit amount allocated to a building applies for the year the allocation is made and for all future years of the compliance period.

Allowable credit authority

General rules.—The annual credit authority limitation for each State is equal to $1.25 for every individual who is a resident of the State (as determined by the most recent estimate of the State's population released by the Bureau of the Census before the beginning of the year to which the limitation applies). For purposes of the credit authority limitation, the District of Columbia and U.S. possessions (e.g., Puerto Rico, the Virgin Islands, Guam, and American Samoa) are treated as States.

Special set-aside for qualified nonprofit organizations.—A portion of each State's credit authority limitation is set aside for exclusive use by qualified nonprofit organizations. This set-aside is equal to $0.125 per resident of the State. This set-aside amount may not be changed by State action, either legislative or gubernatorial. In ad-

[23] A technical amendment may be needed so that the statute reflects this intent.

[24] A technical amendment may be needed so that the statute reflects this intent. Credits allocated pursuant to an earlier binding commitment are counted against the State's annual credit authority limitation in the calendar year of the allocation.

dition to the special set-aside, qualified nonprofit organization projects may be allocated any additional amount of a State's remaining credit authority.

To qualify for allocations from this set-aside, an organization must be a section 501(c)(3) or 501(c)(4) organization, one of the exempt purposes of which includes the fostering of low-income housing, and the qualifying project with respect to which the credits are allocated must be one in which such organization materially participates (within the meaning of the passive loss rule). Among the operations in which the organization must be involved in on a regular, continuous, and substantial basis, in addition to the continuing operation of the project, is the development of the project.

Credits subject to the credit authority limitation

Generally, credits subject to the State credit authority limitation include any credits attributable to expenditures not financed with tax-exempt bonds subject to the new private activity bond volume limitation.

In the case of a building financed with the proceeds of tax-exempt bonds subject to the bond volume limitation (Code sec. 146), if 70 percent or more of the aggregate basis of the building and land on which the building is located is financed with such proceeds, no portion of the credits attributable to such building is subject to the credit authority limitation.

If less than 70 percent of the aggregate basis of the building and land on which the building is located is financed with tax-exempt bonds subject to the bond volume limitation, only credits attributable to those bond-financed expenditures are not subject to the credit authority limitation.

Allocation of credit authority limitation among the State and other qualified governmental units therein

In general.—Each State's credit authority limitation is allocated among the various governmental units within the State pursuant to three alternative procedures.

Under the first procedure, each State's credit authority limitation is allocated in its entirety to the State housing agency until either the governor or the legislature makes a different allocation. If more than one such agency exists, they are treated as one agency. In the absence of a qualified State agency, no allocation may occur until provided by either the governor or the legislature.

Under the second procedure, the governor of each State is provided authority to allocate the State's credit authority limitation among all of the governmental units and other issuing authorities. This authority and any allocation rules established by the governor terminate as of the effective date of any overriding State legislation.

Under the third procedure, the State legislature may enact a law providing for a different allocation than that provided under the first or second procedures. Under this authority, the State legislature may allocate all or any portion of the State limitation to any governmental unit or other issuing authority in the State.

Congress intended that any allocation procedure established by the governor or State legislature give balanced consideration to the low-income housing needs of the entire State.

Congress desired to clarify that gubernatorial proclamations issued before the date of enactment of the Act (October 22, 1986) or State legislation enacted before that date is recognized for purposes of allocating the credit authority limitations, provided that the proclamation or legislation refers to the low-income housing tax credit authority limitation.

Congress further intended that a State be permitted to allocate available credit authority to a local issuer until a specified date during each year (e.g., November 1) at which time the authority, if unused, may revert to the State for reallocation. Similarly, a State statute may provide discretionary authority to a public official (e.g., the governor) to allocate the State's credit authority limitation. Because the credit authority limitation is an annual amount, however, any authority that has not been used for credits issued before the end of the calendar year expires.

Special rule for constitutional home rule subdivisions.—The Act provides a special allocation rule for certain political subdivisions with home rule powers under a State constitution (Illinois). The home rule subdivisions to which the special allocation rule applies are those home rule subdivisions that are granted home rule powers by the beginning of the calendar year in which the credits are issued pursuant to a State constitution that was adopted in 1970 and became effective on July 1, 1971. In that State, a full portion of the State credit authority limitation is allocated to each home rule subdivision based upon the ratio that the population of that home rule subdivision bears to the population of the entire State. As is true of the other credit authority limitation determinations, this allocation is made using the most recent population estimate from the Bureau of the Census released before the beginning of the calendar year to which the credits relate. The amount so allocated to home rule subdivisions may not be altered by the power to provide a different allocation otherwise granted by the Act to the governor or the State legislature. However, a home rule subdivision may agree to a different allocation.

The portion of a State's credit authority limitation not allocated to constitutional home rule subdivisions then is allocated under essentially the same three procedures described in the previous section. Thus, under the first procedure, the remaining State credit authority limitation is allocated to the State housing agency. Under the second and third procedures described above, the governor or the State legislature may allocate the State limitation other than that allocated to home rule subdivisions to any governmental units (including home rule subdivisions).

For purposes of the rules on State action establishing allocation rules for the credit authority limitation, a mayor of a constitutional home rule subdivision is treated as a governor, and a city council is treated as a State legislature.

Constitutional home rule subdivisions are treated as States for purposes of the credit authority limitation set-aside for qualified nonprofit organizations. Pursuant to their general authority to alter credit allocation, described above, these subdivisions may

agree with the State in which they are located to exchange authority to allocate credits for qualified nonprofit organizations for authority to allocate credits for other projects.

Allocation of set-aside amount for qualified nonprofit organizations.—As described above, a portion of each State's credit authority limitation is set aside exclusively for projects of qualified nonprofit organizations. Although the overall amount of credit authority set aside for these credits may not be reduced by any State action, a State may enact a statute determining which credit authorities in the State may allocate these credits and may allocate the entire set-aside amount to those authorities. Similarly, before any legislation, a governor may determine which authorities may allocate credits under the set-aside. The amount of the remaining credit authority limitation allocated to all other authorities must, of course, be adjusted to take into account any reallocation of the set-aside amount.

Determination of credit amount allocation

A building must receive low-income credit authority from the credit agency in whose jurisdiction the qualifying low-income building is located. The credit agency's remaining authority is reduced by the credit percentage multiplied by the amount of qualified basis granted by the credit agency for the building. The credit agency may grant a smaller credit percentage and a smaller qualified basis amount at the time the allocation is made than the maximum percentage and amount that would otherwise be allowed. Congress intended that the credit agencies reduce the maximum available credit percentage when the financing and rental assistance for a project from all sources is sufficient to provide the continuing operation of the qualifying low-income building without the maximum credit.

A credit agency's credit authority is reduced by the maximum amount of credit granted, whether or not the property ultimately is eligible for this maximum amount, and without regard to the averaging convention used in the first year of the credit period.

If a building is granted more credits than would be claimed in the first year of the credit period, without regard to the averaging convention, such amounts are not restored to the credit agency's authority. Such amounts may, however, be used in a later year by the owner of the building to the extent the credit determined with respect to the building is increased as a result of additions to qualified basis (but not beyond the amount allocated by the agency, and without regard to the reduced percentage applicable to such additions). (See also, the discussion on additions to qualified basis, above.)

Example 1.—Assume in calendar year 1987 a newly constructed building is placed in service and that the building's qualified basis, before consideration of the credit authority limitation, is determined to be $100,000 in that year. The credit agency may allocate any amount of qualified basis to the building, but the taxpayer may treat as his qualified basis only the lesser of (1) the qualified basis of the building, before consideration of the credit authority limitation, or (2) the qualified basis allocated to the building by the credit agency. If the credit agency allocated $100,000 of qualified

basis and the maximum 9 percent credit percentage to the building, the agency's remaining 1987 credit authority would be reduced by $9,000.

Example 2.—Assume $120,000 in qualified basis and a credit percentage of 9 percent were initially authorized by a credit agency in 1987 for a qualified low-income building and that in 1987, the first year of the credit period, the building's qualified basis was $100,000. The credit agency's remaining 1987 credit authority is reduced by $10,800. If in year two of the credit period the qualified basis of the building increases by up to $20,000 due to an increase in the number of low-income units, additional credits may be claimed with respect to this addition to qualified basis without requiring additional credit authority from the credit agency. The credit percentage applicable to the additional qualified basis is two-thirds of the credit percentage applicable to the initial qualified basis. Credits on the additions to qualified basis may be claimed over the remainder of the compliance period.

If the qualified basis of a building is greater than the qualified basis allocated to it by the credit agency, credits may not be claimed on the excess portion unless additional low-income housing credits are allocated to the building by the credit agency. The credit authority of the credit agency is reduced for the calendar year of any such additional allocations.

Generally, no carryover authority for unused credit authority is permitted. A limited exception is provided for buildings placed in service in 1990, if expenditures of 10 percent or more of total project costs are incurred before January 1, 1989. Credit authority for such property may be carried over from the 1989 credit allocation for the credit agency. Congress intended that, for allocations made after 1987, if a building cannot be placed in service in the year for which the allocation was made for reasons beyond the control of the taxpayer, then upon approval by the Treasury Department, the credit allocation will be valid if the building is placed in service in the succeeding year.[25]

Credit agencies are permitted to enter into binding commitments to allocate future credit authority for years before the sunset date to buildings not yet placed in service by binding contracts or other means.

Should a credit agency issue more credits than its credit authority limitation provides, credits will be denied to those buildings last allocated credits until the credit authority limitation is not exceeded.

Credit administration

Credit agencies allocating credits may not condition allocation of credits to the source of financing for the qualifying low-income building. The Act authorizes the Treasury Department to prescribe regulations that may require credit recipients to pay a reasonable fee to cover administrative expenses of the credit agency. The fact that credits must be allocated on a building-by-building basis does not preclude a credit agency from charging a single fee for process-

[25] A technical amendment may be needed so that the statute reflects this intent.

ing credits for a single project with multiple buildings or for multiple projects of a common taxpayer.

Agencies allocating credits must file reports with the Treasury Department containing (1) the maximum applicable percentage and qualified basis of each building, (2) the fees, if any, charged to credit recipients, (3) the aggregate amount of credits issued, and (4) other information required by Treasury. The time and manner of filing such reports and other information required are to be specified by the Treasury Department.

Transferability

A new owner of a building during its 15-year compliance period is eligible to continue to receive the credit as if the new owner were the original owner, using the same qualified basis and credit percentages as used by the original owner. Rehabilitation expenditures on such property may qualify for a credit in the same manner as rehabilitation expenditures on other qualifying property. The accelerated portion of credits claimed in previous years will be recaptured upon a transfer, subject to the election of the original owner to post a bond. All dispositions of ownership interests in buildings are treated as transfers for purposes of recapture, except for a special rule for certain partnerships. (There is no election for the new owner to assume the recapture liability for prior year credits.)

At-risk limitation

Property with respect to which a low-income housing tax credit is claimed is subject to an at-risk limitation similar to the investment tax credit at-risk rules in the case of nonqualified nonrecourse financing. An exception is provided for lenders related to the buyer of the low-income housing property. Another exception provides that the general investment tax credit at-risk rule, limiting the amount of nonrecourse financing to 80 percent of the credit base of the property, does not apply in the case of the low-income housing tax credit.[26]

A further exception is provided for financing (including seller financing) not in excess of 60 percent of the basis of the property that is lent by 501(c)(3) and 501(c)(4) organizations whose exempt purpose includes fostering low-income housing. Further, if the rate of interest for any financing qualifying for this exception is below the applicable Federal rate at the time the financing is incurred, less 1 percentage point, then the qualified basis to which such financing relates shall be reduced to reflect the present value of the payments of principal and interest, using as the discount rate such applicable Federal rate. The credit is recaptured if the financing provided by such organizations is not repaid with interest by the end of the 15-year credit compliance period.

Coordination with other provisions

The credit is subject to the rules of the general business credit, including the maximum amount of income tax liability that may

[26] This exception was enacted in the Omnibus Budget Reconciliation Act of 1986, P.L. 99-509.

be reduced by a general business tax credit in any year. Unused credits for any taxable year may be carried back to each of the 3 preceding taxable years and then carried forward to each of the 15 following taxable years. Congress intended that no credits be carried back to taxable years ending prior to January 1, 1987.[27]

For purposes of the rules in the Act limiting passive loss deductions, the credit (but not losses) is treated as arising from rental real estate activities in which the taxpayer actively participates. Credits may be used to offset tax on up to $25,000 of nonpassive income, subject to a phaseout between $200,000 and $250,000 of adjusted gross income (disregarding passive losses).

The basis of property for purposes of depreciation is not reduced by the amount of low-income credits claimed.

Effective Date

The credit is effective for buildings placed in service after December 31, 1986, and before January 1, 1991, other than (1) property to which the depreciation rules of prior-law apply or (2) property with respect to which any investor is eligible for passive losses under the special transitional exception contained in section 502 of the Act. Congress further intended that no property to which the provision of prior law allowing five-year amortization of rehabilitation expenditures applies may be included in eligible basis.[28] As stated above, all buildings eligible for the credit must be placed in service before January 1, 1991.[29] A building placed in service in 1990 is eligible for the credit, however, only if expenditures of 10 percent or more of the reasonably expected cost of the building are incurred before January 1, 1989. Under a special rule, described above, credit authority for such property placed in service in 1990 may be carried over from the 1989 volume allocation for any credit agency.

Revenue Effect

The low-income rental housing tax credit is estimated to reduce fiscal year budget receipts by $67 million in 1987, $324 million in 1988, $705 million in 1989, $1,011 million in 1990, and $1,139 million in 1991.

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[27] A technical amendment may be needed so that the statute reflects this intent.

[28] A technical amendment may be needed so that the statute reflects this intent.

[29] The Act contains a general rule preventing the allocation of credit authority to buildings placed in service after 1990. Congress intended that tax-exempt bond-financed projects be treated in the same manner as other projects, and are not eligible for the credit if placed in service after 1990. A technical amendment may be needed so that the statute reflects this intent. Such an amendment was included in the versions of H. Con. Res. 395 which passed the House of Representatives and Senate in the 99th Congress.

Section 9

IRS Section 42

Internal Revenue Code § 42 Low-income housing credit.

(a) In general.
For purposes of section 38 , the amount of the low-income housing credit determined under this section for any taxable year in the credit period shall be an amount equal to—

(1) the applicable percentage of

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

(b) Applicable percentage: 70 percent present value credit for certain new buildings; 30 percent present value credit for certain other buildings.
For purposes of this section —

(1) Building placed in service during 1987.
In the case of any qualified low-income building placed in service by the taxpayer during 1987, the term "applicable percentage" means—

(A) 9 percent for new buildings which are not federally subsidized for the taxable year, or

(B) 4 percent for—

(i) new buildings which are federally subsidized for the taxable year, and

(ii) existing buildings.

(2) Buildings placed in service after 1987.

(A) In general. In the case of any qualified low-income building placed in service by the taxpayer after 1987, the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the earlier of—

(i) the month in which such building is placed in service, or

(ii) at the election of the taxpayer—

(I) the month in which the taxpayer and the housing credit agency enter into an agreement with respect to such building (which is binding on such agency, the taxpayer, and all successors in interest) as to the housing credit dollar amount to be allocated to such building, or

(II) in the case of any building to which subsection (h)(4)(B) applies, the month in which the tax-exempt obligations are issued.

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

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

(i) 70 percent of the qualified basis of a building described in paragraph (1)(A) , and

(ii) 30 percent of the qualified basis of a building described in paragraph (1)(B) .

(C) Method of discounting. The present value under subparagraph (B) shall be determined—

(i) as of the last day of the 1st year of the 10-year period referred to in subparagraph (B) ,

(ii) by using a discount rate equal to 72 percent of the average of the annual Federal mid-term rate and the annual Federal long-term rate applicable under section 1274(d)(1) to the month applicable under clause (i) or (ii) of subparagraph (A) and compounded annually, and

(iii) by assuming that the credit allowable under this section for any year is received on the last day of such year.

(3) Cross references.

(A) For treatment of certain rehabilitation expenditures as separate new buildings, see subsection (e) .

(B) For determination of applicable percentage for increases in qualified basis after the 1st year of the credit period, see subsection (f)(3) .

(C) For authority of housing credit agency to limit applicable percentage and qualified basis which may be taken into account

under this section with respect to any building, see subsection (h)(7) .

(c) Qualified basis; qualified low-income building.
For purposes of this section —

(1) Qualified basis.

(A) Determination. The qualified basis of any qualified low-income building for any taxable year is an amount equal to—

(i) the applicable fraction (determined as of the close of such taxable year) of

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

(B) Applicable fraction. For purposes of subparagraph (A) , the term “applicable fraction” means the smaller of the unit fraction or the floor space fraction.

(C) Unit fraction. For purposes of subparagraph (B) , the term “unit fraction” means the fraction—

(i) the numerator of which is the number of low-income units in the building, and

(ii) the denominator of which is the number of residential rental units (whether or not occupied) in such building.

(D) Floor space fraction. For purposes of subparagraph (B) , the term “floor space fraction” means the fraction—

(i) the numerator of which is the total floor space of the low-income units in such building, and

(ii) the denominator of which is the total floor space of the residential rental units (whether or not occupied) in such building.

(E) Qualified basis to include portion of building used to provide supportive services for homeless. In the case of a qualified low-income building described in subsection (i)(3)(B)(iii) , the qualified basis of such building for any taxable year shall be increased by the lesser of—

(i) so much of the eligible basis of such building as is used throughout the year to provide supportive services designed to assist tenants in locating and retaining permanent housing, or

(ii) 20 percent of the qualified basis of such building (determined without regard to this subparagraph).

(2) Qualified low-income building.
The term "qualified low-income building" means any building—

(A) which is part of a qualified low-income housing project at all times during the period—

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

(ii) ending on the last day of the compliance period with respect to such building, and

(B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.

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

(d) Eligible basis.
For purposes of this section —

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

(2) Existing buildings.

(A) In general. The eligible basis of an existing building is—

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

(ii) zero in any other case.

(B) Requirements. A building meets the requirements of this subparagraph if—

(i) the building is acquired by purchase (as defined in section 179(d)(2)),

(ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the later of—

(I) the date the building was last placed in service, or

(II) the date of the most recent nonqualified substantial improvement of the building,

(iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service, and

(iv) except as provided in subsection (f)(5) , a credit is allowable under subsection (a) by reason of subsection (e) with respect to the building.

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

(D) Special rules for subparagraph (B) .

(i) Nonqualified substantial improvement. For purposes of subparagraph (B)(ii) —

(I) In general. The term “nonqualified substantial improvement” means any substantial improvement if section 167(k) (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990 [11/5/90]) was elected with respect to such improvement or section 168 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) applied to such improvement.

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

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

(ii) Special rules for certain transfers. For purposes of determining under subparagraph (B)(ii) when a building was last placed in service, there shall not be taken into account any placement in service—

(I) in connection with the acquisition of the building in a transaction in which the basis of the building in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such building in the hands of the person from whom acquired,

(II) by a person whose basis in such building is determined under section 1014(a) (relating to property acquired from a decedent),

(III) by any governmental unit or qualified nonprofit organization (as defined in subsection (h)(5)) if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such unit or organization and all the income from such property is exempt from Federal income taxation,

(IV) by any person who acquired such building by foreclosure (or by instrument in lieu of foreclosure) of any purchase-money security interest held by such person if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such person and such building is resold within 12 months after the date such building is

placed in service by such person after such foreclosure, or

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

(iii) Related person, etc.

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

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

(3) Eligible basis reduced where disproportionate standards for units.

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

(B) Exception where taxpayer elects to exclude excess costs.

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

(I) the excess described in clause (ii) with respect to such unit is not greater than 15 percent of the cost described in clause (ii)(II) , and

(II) the taxpayer elects to exclude from the eligible basis of such building the excess described in clause (ii) with respect to such unit.

(ii) Excess. The excess described in this clause with respect to any unit is the excess of—

(I) the cost of such unit, over

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

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

(4) Special rules relating to determination of adjusted basis.
For purposes of this subsection —

(A) In general. Except as provided in subparagraphs (B) and (C) , the adjusted basis of any building shall be determined without regard to the adjusted basis of any property which is not residential rental property.

(B) Basis of property in common areas, etc., included. The adjusted basis of any building shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation) used in common areas or provided as comparable amenities to all residential rental units in such building.

(C) Inclusion of basis of property used to provide services for certain nontenants.

(i) In general. The adjusted basis of any building located in a qualified census tract (as defined in paragraph (5)(C)) shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation and not otherwise taken into account) used throughout the taxable year in providing any community service facility.

(ii) Limitation. The increase in the adjusted basis of any building which is taken into account by reason of clause (i)

shall not exceed 10 percent of the eligible basis of the qualified low-income housing project of which it is a part. For purposes of the preceding sentence, all community service facilities which are part of the same qualified low-income housing project shall be treated as one facility.

(iii) Community service facility. For purposes of this subparagraph , the term “community service facility” means any facility designed to serve primarily individuals whose income is 60 percent or less of area median income (within the meaning of subsection (g)(1)(B)).

(D) No reduction for depreciation. The adjusted basis of any building shall be determined without regard to paragraphs (2) and (3) of section 1016(a) .

(5) Special rules for determining eligible basis.

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

(B) Eligible basis not to include expenditures where section 167(k) elected. The eligible basis of any building shall not include any portion of its adjusted basis which is attributable to amounts with respect to which an election is made under section 167(k) (as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990 [11/5/90]).

(C) Increase in credit for buildings in high cost areas.

(i) In general. In the case of any building located in a qualified census tract or difficult development area which is designated for purposes of this subparagraph —

(I) in the case of a new building, the eligible basis of such building shall be 130 percent of such basis determined without regard to this subparagraph , and

(II) in the case of an existing building, the rehabilitation expenditures taken into account under

subsection (e) shall be 130 percent of such expenditures determined without regard to this subparagraph .

(ii) Qualified census tract.

(I) In general. The term “qualified census tract” means any census tract which is designated by the Secretary of Housing and Urban Development and, for the most recent year for which census data are available on household income in such tract, either in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income for such year or which has a poverty rate of at least 25 percent. If the Secretary of Housing and Urban Development determines that sufficient data for any period are not available to apply this clause on the basis of census tracts, such Secretary shall apply this clause for such period on the basis of enumeration districts.

(II) Limit on MSA's designated. The portion of a metropolitan statistical area which may be designated for purposes of this subparagraph shall not exceed an area having 20 percent of the population of such metropolitan statistical area.

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

(iii) Difficult development areas.

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

(II) Limit on areas designated. The portions of metropolitan statistical areas which may be designated for purposes of this subparagraph shall not exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas.

A comparable rule shall apply to nonmetropolitan areas.

(iv) Special rules and definitions. For purposes of this subparagraph —

(I) population shall be determined on the basis of the most recent decennial census for which data are available,

(II) area median gross income shall be determined in accordance with subsection (g)(4) ,

(III) the term “metropolitan statistical area” has the same meaning as when used in section 143(k)(2)(B) , and

(IV) the term “nonmetropolitan area” means any county (or portion thereof) which is not within a metropolitan statistical area.

(6) Credit allowable for certain federally-assisted buildings acquired during 10-year period described in paragraph (2)(B)(ii) .

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

(i) to avert an assignment of the mortgage secured by property in the project (of which such building is a part) to the Department of Housing and Urban Development or the Farmers Home Administration, or

(ii) to avert a claim against a Federal mortgage insurance fund (or such Department or Administration) with respect to a mortgage which is so secured.

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

(B) Federally-assisted building. For purposes of subparagraph (A) , the term “federally-assisted building” means any building which is substantially assisted, financed, or operated under—

(i) section 8 of the United States Housing Act of 1937,

(ii) section 221(d)(3) or 236 of the National Housing Act, or

(iii) section 515 of the Housing Act of 1949,

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

(C) Low-income buildings where mortgage may be prepaid. A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to a federally-assisted building described in clause (ii) or (iii) of subparagraph (B) if—

(i) the mortgage on such building is eligible for prepayment under subtitle B of the Emergency Low Income Housing Preservation Act of 1987 or under section 502(c) of the Housing Act of 1949 at any time within 1 year after the date of the application for such a waiver,

(ii) the appropriate Federal official certifies to the Secretary that it is reasonable to expect that, if the waiver is not granted, such building will cease complying with its low-income occupancy requirements, and

(iii) the eligibility to prepay such mortgage without the approval of the appropriate Federal official is waived by all persons who are so eligible and such waiver is binding on all successors of such persons.

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

(E) Appropriate federal official. For purposes of subparagraph (A) , the term “appropriate Federal official” means—

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

(ii) the Secretary of Agriculture in the case of any building described in subparagraph (B) by reason of clause (iii) thereof .

(7) Acquisition of building before end of prior compliance period.

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

(i) paragraph (2)(B) shall not apply, but

(ii) the credit allowable by reason of subsection (a) to the taxpayer for any period after such acquisition shall be equal to the amount of credit which would have been allowable under subsection (a) for such period to the prior owner referred to in subparagraph (B) had such owner not disposed of the building.

(B) Description of building. A building is described in this subparagraph if—

(i) a credit was allowed by reason of subsection (a) to any prior owner of such building, and

(ii) the taxpayer acquired such building before the end of the compliance period for such building with respect to such prior owner (determined without regard to any disposition by such prior owner).

(e) Rehabilitation expenditures treated as separate new building.

(1) In general.
Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of this section as a separate new building.

(2) Rehabilitation expenditures.
For purposes of paragraph (1) —

(A) In general. The term “rehabilitation expenditures” means amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building.

(B) Cost of acquisition, etc, not included. Such term does not include the cost of acquiring any building (or interest therein) or any amount not permitted to be taken into account under paragraph (3) or (4) of subsection (d) .

(3) Minimum expenditures to qualify.

(A) In general. Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if—

(i) the expenditures are allocable to 1 or more low-income units or substantially benefit such units, and

(ii) the amount of such expenditures during any 24-month period meets the requirements of whichever of the following subclauses requires the greater amount of such expenditures:

(I) The requirement of this subclause is met if such amount is not less than 10 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).

(II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is $3,000 or more.

(B) Exception from 10 percent rehabilitation. In the case of a building acquired by the taxpayer from a governmental unit, at the election of the taxpayer, subparagraph (A)(ii)(I) shall not apply and the credit under this section for such rehabilitation expenditures shall be determined using the percentage applicable under subsection (b)(2)(B)(ii) .

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

(4) Special rules.
For purposes of applying this section with respect to expenditures which are treated as a separate building by reason of this subsection —

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

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

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

(5) No double counting.
Rehabilitation expenditures may, at the election of the taxpayer, be taken into account under this subsection or subsection (d)(2)(A)(i) but not under both such subsections.

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

(f) Definition and special rules relating to credit period.

(1) Credit period defined.
For purposes of this section , the term “credit period” means, with respect to any building, the period of 10 taxable years beginning with—

(A) the taxable year in which the building is placed in service, or

(B) at the election of the taxpayer, the succeeding taxable year,

but only if the building is a qualified low-income building as of the close of the 1st year of such period. The election under subparagraph (B) , once made, shall be irrevocable.

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

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

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

(ii) the denominator of which is 12.

(B) Disallowed 1st year credit allowed in 11th year. Any reduction by reason of subparagraph (A) in the credit allowable (without

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

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

(A) In general. In the case of any building which was a qualified low-income building as of the close of the 1st year of the credit period, if—

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

(ii) the qualified basis of such building as of the close of the 1st year of the credit period,

the applicable percentage which shall apply under subsection (a) for the taxable year to such excess shall be the percentage equal to 2/3 of the applicable percentage which (after the application of subsection (h)) would but for this paragraph apply to such basis.

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

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

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

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

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

(i) In general. In the case of a building described in clause (ii) —

(I) subsection (d)(2)(B)(iv) shall not apply, and

(II) the credit period for such building shall not begin before the taxable year which would be the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building under the modifications described in clause (ii)(II) .

(ii) Building described. A building is described in this clause if—

(I) a waiver is granted under subsection (d)(6)(C) with respect to the acquisition of the building, and

(II) a credit would be allowed for rehabilitation expenditures with respect to such building if subsection (e)(3)(A)(ii)(I) did not apply and if subsection (e)(3)(A)(ii)(II) were applied by substituting “$2,000” for “$3,000”.

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

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

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

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

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

(2) Rent-restricted units.

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

(B) Gross rent. For purposes of subparagraph (A) , gross rent—

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

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

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

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

For purposes of clause (iii) , the term “supportive service” means any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent and avoid placement in a hospital, nursing home, or intermediate care facility for the mentally or physically handicapped. In the case of a single-room occupancy unit or a building described in subsection (i)(3)(B)(iii) , such term includes

any service provided to assist tenants in locating and retaining permanent housing.

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

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

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

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

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

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

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

comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation".

(E) Units where federal rental assistance is reduced as tenant's income increases. If the gross rent with respect to a residential unit exceeds the limitation under subparagraph (A) by reason of the fact that the income of the occupants thereof exceeds the income limitation applicable under paragraph (1) , such unit shall, nevertheless, be treated as a rent-restricted unit for purposes of paragraph (1) if—

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

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

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

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

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

(3) Date for meeting requirements.

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

(B) Buildings which rely on later buildings for qualification.

(i) In general. In determining whether a building (hereinafter in this subparagraph referred to as the "prior building") is a qualified low-income building, the taxpayer

may take into account 1 or more additional buildings placed in service during the 12-month period described in subparagraph (A) with respect to the prior building only if the taxpayer elects to apply clause (ii) with respect to each additional building taken into account.

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

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

(C) Special rule. A building—

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

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

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

(D) Projects with more than 1 building must be identified. For purposes of this section , a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii)), each building which is (or will be) part of such project is identified in such form and manner as the Secretary may provide.

(4) Certain rules made applicable.
Paragraphs (2) (other than subparagraph (A) thereof), (3) , (4) , (5) , (6) , and (7) of section 142(d) , and section 6652(j) , shall apply for purposes of determining whether any project is a qualified low-income housing project

and whether any unit is a low-income unit; except that, in applying such provisions for such purposes, the term “gross rent” shall have the meaning given such term by paragraph (2)(B) of this subsection

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

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

> (A) all amounts so paid are refunded to the occupant on the cessation of his occupancy of a unit in the project, and
>
> (B) the purchase of the unit is not permitted until after the close of the compliance period with respect to the building in which the unit is located.

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

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

(8) Waiver of certain de minimis errors and recertifications.
On application by the taxpayer, the Secretary may waive—

> (A) any recapture under subsection (j) in the case of any de minimis error in complying with paragraph (1) , or
>
> (B) any annual recertification of tenant income for purposes of this subsection , if the entire building is occupied by low-income tenants.

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

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

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

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

(C) Exception where binding commitment. An allocation meets the requirements of this subparagraph if there is a binding commitment (not later than the close of the calendar year in which the building is placed in service) by the housing credit agency to allocate a specified housing credit dollar amount to such building beginning in a specified later taxable year.

(D) Exception where increase in qualified basis.

(i) In general. An allocation meets the requirements of this subparagraph if such allocation is made not later than the close of the calendar year in which ends the taxable year to which it will 1st apply but only to the extent the amount of such allocation does not exceed the limitation under clause (ii) .

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

(I) the qualified basis of such building as of the close of the 1st taxable year to which such allocation will apply, over

(II) the qualified basis of such building as of the close of the 1st taxable year to which the most recent prior housing credit allocation with respect to such building applied.

(iii) Housing credit dollar amount reduced by full allocation. Notwithstanding clause (i) , the full amount of the allocation shall be taken into account under paragraph (2) .

(E) Exception where 10 percent of cost incurred.

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

(ii) Qualified building. For purposes of clause (i) , the term “qualified building” means any building which is part of a project if the taxpayer's basis in such project (as of the later of the date which is 6 months after the date that the allocation was made or the close of the calendar year in which the allocation is made) is more than 10 percent of the taxpayer's reasonably expected basis in such project (as of the close of the second calendar year referred to in clause (i)). Such term does not include any existing building unless a credit is allowable under subsection (e) for rehabilitation expenditures paid or incurred by the taxpayer with respect to such building for a taxable year ending during the second calendar year referred to in clause (i) or the prior taxable year.

(F) Allocation of credit on a project basis.

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

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

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

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

(ii) Project period. For purposes of clause (i) , the term "project period" means the period—

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

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

(2) Allocated credit amount to apply to all taxable years ending during or after credit allocation year.
Any housing credit dollar amount allocated to any building for any calendar year—

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

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

(3) Housing credit dollar amount for agencies.

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

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

(C) State housing credit ceiling. The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to the sum of—

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

(ii) the greater of—

(I) $1.75 ($1.50 for 2001) multiplied by the State population, or

(II) $2,000,000,

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

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

For purposes of clause (i) , the unused State housing credit ceiling for any calendar year is the excess (if any) of the sum of the amounts described in clauses (ii) through (iv) over the aggregate housing credit dollar amount allocated for such year. For purposes of clause (iii) , the amount of State housing credit ceiling returned in the calendar year equals the housing credit dollar amount previously allocated within the State to any project which fails to meet the 10 percent test under paragraph (1)(E)(ii) on a date after the close of the calendar year in which the allocation was made or which does not become a qualified low-income housing project within the period required by this section or the terms of the allocation or to any project with respect to which an allocation is cancelled by mutual consent of the housing credit agency and the allocation recipient.

(D) Unused housing credit carryovers allocated among certain states.

(i) In general. The unused housing credit carryover of a State for any calendar year shall be assigned to the Secretary for allocation among qualified States for the succeeding calendar year.

(ii) Unused housing credit carryover. For purposes of this subparagraph , the unused housing credit carryover of a State for any calendar year is the excess (if any) of—

(I) the unused State housing credit ceiling for the year preceding such year, over

(II) the aggregate housing credit dollar amount allocated for such year.

(iii) Formula for allocation of unused housing credit carryovers among qualified states. The amount allocated under this subparagraph to a qualified State for any calendar year shall be the amount determined by the Secretary to bear the same ratio to the aggregate unused

housing credit carryovers of all States for the preceding calendar year as such State's population for the calendar year bears to the population of all qualified States for the calendar year. For purposes of the preceding sentence, population shall be determined in accordance with section 146(j) .

(iv) Qualified State. For purposes of this subparagraph , the term “qualified State” means, with respect to a calendar year, any State—

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

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

(E) Special rule for states with constitutional home rule cities. For purposes of this subsection —

(i) In general. The aggregate housing credit dollar amount for any constitutional home rule city for any calendar year shall be an amount which bears the same ratio to the State housing credit ceiling for such calendar year as—

(I) the population of such city, bears to

(II) the population of the entire State.

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

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

(F) State may provide for different allocation. Rules similar to the rules of section 146(e) (other than paragraph (2)(B) thereof) shall apply for purposes of this paragraph .

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

(H) Cost-of-living adjustment.

(i) In general. In the case of a calendar year after 2002, the $2,000,000 and $1.75 amounts in subparagraph (C) shall each be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting “calendar year 2001” for “calendar year 1992” in subparagraph (B) thereof.

(ii) Rounding.

(I) In the case of the $2,000,000 amount, any increase under clause (i) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

(II) In the case of the $1.75 amount, any increase under clause (i) which is not a multiple of 5 cents shall be rounded to the next lowest multiple of 5 cents.

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

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

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

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

(B) Special rule where 50 percent or more of building is financed with tax-exempt bonds subject to volume cap. For purposes of subparagraph (A) , if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed by any obligation described in subparagraph (A) , paragraph (1) shall not apply to any portion of the credit allowable under subsection (a) with respect to such building.

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

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

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

(C) Qualified nonprofit organization. For purposes of this paragraph , the term “qualified nonprofit organization” means any organization if—

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

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

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

(D) Treatment of certain subsidiaries.

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

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

(E) State may not override set-aside. Nothing in subparagraph (F) of paragraph (3) shall be construed to permit a State not to comply with subparagraph (A) of this paragraph .

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

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

(B) Extended low-income housing commitment. For purposes of this paragraph , the term “extended low-income housing commitment” means any agreement between the taxpayer and the housing credit agency—

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

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

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

(iv) which prohibits the refusal to lease to a holder of a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937 because of the status of the prospective tenant as such a holder,

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

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

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

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

(ii) Buildings financed by tax-exempt bonds. If paragraph (4) applies to any building the amount of credit allowed in any taxable year may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building. Such commitment may be amended to increase such fraction.

(D) Extended use period. For purposes of this paragraph , the term “extended use period” means the period—

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

(ii) ending on the later of—

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

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

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

(i) In general. The extended use period for any building shall terminate—

(I) on the date the building is acquired by foreclosure (or instrument in lieu of foreclosure)

unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period, or

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

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

(ii) Eviction, etc. of existing low-income tenants not permitted. The termination of an extended use period under clause (i) shall not be construed to permit before the close of the 3-year period following such termination—

(I) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or

(II) any increase in the gross rent with respect to such unit not otherwise permitted under this section .

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

(i) the sum of—

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

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

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

(ii) cash distributions from (or available for distribution from) the project.

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

(G) Adjusted investor equity.

(i) In general. For purposes of subparagraph (E) , the term “adjusted investor equity” means, with respect to any calendar year, the aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to—

(I) such amount, multiplied by

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

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

(ii) Cost-of-living increases in excess of 5 percent not taken into account. Under regulations prescribed by the Secretary, if the CPI for any calendar year (as defined in section 1(f)(4)) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i) .

(iii) Base calendar year. For purposes of this subparagraph , the term “base calendar year” means the calendar year with or within which the 1st taxable year of the credit period ends.

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

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

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

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

(7) Special rules.

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

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

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

(i) In general. The amount of the credit determined under this section with respect to any building shall not exceed the clause (ii) percentage of the amount of the credit which

would (but for this subparagraph) be determined under this section with respect to such building.

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

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

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

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

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

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

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

(8) Other definitions.
For purposes of this subsection —

(A) Housing credit agency. The term “housing credit agency” means any agency authorized to carry out this subsection .

(B) Possessions treated as states. The term “State” includes a possession of the United States.

(i) Definitions and special rules.
For purposes of this section —

(1) Compliance period.
The term “compliance period” means, with respect to any building, the period of 15 taxable years beginning with the 1st taxable year of the credit period with respect thereto.

(2) Determination of whether building is federally subsidized.

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

(B) Election to reduce eligible basis by balance of loan or proceeds of obligations. A loan or tax-exempt obligation shall not be taken into account under subparagraph (A) if the taxpayer elects to exclude from the eligible basis of the building for purposes of subsection (d) —

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

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

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

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

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

(D) Below market federal loan. For purposes of this paragraph , the term “below market Federal loan” means any loan funded in whole or in part with Federal funds if the interest rate payable on such loan is less than the applicable Federal rate in effect under section 1274(d)(1) (as of the date on which the loan was made). Such term shall not include any loan which would be a below market Federal

loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 (as in effect on the date of the enactment of this sentence).

(E) Buildings receiving home assistance or Native American Housing assistance.

(i) In general. Assistance provided under the HOME Investment Partnerships Act (as in effect on the date of the enactment of this subparagraph or the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4101 et seq.) (as in effect on October 1, 1997) with respect to any building shall not be taken into account under subparagraph (D) if 40 percent or more of the residential units in the building are occupied by individuals whose income is 50 percent or less of area median gross income. Subsection (d)(5)(C) shall not apply to any building to which the preceding sentence applies.

(ii) Special rule for certain high-cost housing areas. In the case of a building located in a city described in section 142(d)(6) , clause (i) shall be applied by substituting “25 percent” for “40 percent”.

(3) Low-income unit.

(A) In general. The term “low-income unit” means any unit in a building if—

(i) such unit is rent-restricted (as defined in subsection (g)(2)), and

(ii) the individuals occupying such unit meet the income limitation applicable under subsection (g)(1) to the project of which such building is a part.

(B) Exceptions.

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

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

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

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

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

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

(C) Special rule for buildings having 4 or fewer units. In the case of any building which has 4 or fewer residential rental units, no unit in such building shall be treated as a low-income unit if the units in such building are owned by—

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

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

(D) Certain students not to disqualify unit. A unit shall not fail to be treated as a low-income unit merely because it is occupied—

(i) by an individual who is—

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

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

(ii) entirely by full-time students if such students are—

Caution: Subclause (i)(3)(D)(ii)(I), following, is effective for tax. yrs. begin. before 1/1/2005. For subclause (i)(3)(D)(ii)(I), effective for tax. yrs. begin. after 12/31/2004, see below.

(I) single parents and their children and such parents and children are not dependents (as defined in section 152) of another individual, or

Caution: Subclause (i)(3)(D)(ii)(I), following, is effective for tax. yrs. begin. after 12/31/2004. For subclause (i)(3)(D)(ii)(I), effective for tax. yrs. begin. before 1/1/2005, see above.

(I) single parents and their children and such parents and children are not dependents (as defined in section 152 , determined without regard to subsections (b)(1) , (b)(2) , and (d)(1)(B) thereof) of another individual, or

(II) married and file a joint return.

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

(i) In general. Subparagraph (C) shall not apply to the acquisition or rehabilitation of a building pursuant to a development plan of action sponsored by a State or local government or a qualified nonprofit organization (as defined in subsection (h)(5)(C)).

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

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

(4) New building.
The term “new building” means a building the original use of which begins with the taxpayer.

(5) Existing building.
The term “existing building” means any building which is not a new building.

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

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

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

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

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

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

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

(j) Recapture of credit.

(1) In general.
If—

(A) as of the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than

(B) the amount of such basis as of the close of the preceding taxable year, then the taxpayer's tax under this chapter for the taxable year shall be increased by the credit recapture amount.

(2) Credit recapture amount.
For purposes of paragraph (1) , the credit recapture amount is an amount equal to the sum of—

(A) the aggregate decrease in the credits allowed to the taxpayer under section 38 for all prior taxable years which would have resulted if the accelerated portion of the credit allowable by reason of this section were not allowed for all prior taxable years with respect to the excess of the amount described in paragraph (1)(B) over the amount described in paragraph (1)(A) , plus

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

No deduction shall be allowed under this chapter for interest described in subparagraph (B) .

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

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

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

(4) Special rules.

(A) Tax benefit rule. The tax for the taxable year shall be increased under paragraph (1) only with respect to credits allowed by reason

of this section which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carryforwards and carrybacks under section 39 shall be appropriately adjusted.

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

(C) No recapture of additional credit allowable by reason of subsection (f)(3) . Paragraph (1) shall apply to a decrease in qualified basis only to the extent such decrease exceeds the amount of qualified basis with respect to which a credit was allowable for the taxable year referred to in paragraph (1)(B) by reason of subsection (f)(3) .

(D) No credits against tax. Any increase in tax under this subsection shall not be treated as a tax imposed by this chapter for purposes of determining the amount of any credit under this chapter.

(E) No recapture by reason of casualty loss. The increase in tax under this subsection shall not apply to a reduction in qualified basis by reason of a casualty loss to the extent such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary.

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

(i) such increase results from a de minimis change in the floor space fraction under subsection (c)(1) , and

(ii) the building is a qualified low-income building after such change.

(5) Certain partnerships treated as the taxpayer.

(A) In general. For purposes of applying this subsection to a partnership to which this paragraph applies—

(i) such partnership shall be treated as the taxpayer to which the credit allowable under subsection (a) was allowed,

(ii) the amount of such credit allowed shall be treated as the amount which would have been allowed to the partnership were such credit allowable to such partnership,

(iii) paragraph (4)(A) shall not apply, and

(iv) the amount of the increase in tax under this subsection for any taxable year shall be allocated among the partners of such partnership in the same manner as such partnership's taxable income for such year is allocated among such partners.

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

(C) Special rules.

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

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

(6) No recapture on disposition of building (or interest therein) where bond posted.
In the case of a disposition of a building or an interest therein the taxpayer shall be discharged from liability for any additional tax under this subsection by reason of such disposition if—

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

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

(k) Application of at-risk rules.
For purposes of this section —

(1) In general.
Except as otherwise provided in this subsection , rules similar to the rules of section 49(a)(*1*) (other than subparagraphs (D)(ii)(II) and (D)(iv)(I) thereof), section 49(a)(2) , and section 49(b)(1) shall apply in determining

the qualified basis of any building in the same manner as such sections apply in determining the credit base of property.

(2) Special rules for determining qualified person.
For purposes of paragraph (1) —

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

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

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

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

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

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

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

(D) Repayment of principal and interest. The requirements of this subparagraph are met with respect to any financing if such financing is fully repaid on or before the earliest of—

(i) the date on which such financing matures,

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

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

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

(3) Present value of financing.
If the rate of interest on any financing described in paragraph (2)(A) is less than the rate which is 1 percentage point below the applicable Federal rate as of the time such financing is incurred, then the qualified basis (to which such financing relates) of the qualified low-income building shall be the present value of the amount of such financing, using as the discount rate such applicable Federal rate. For purposes of the preceding sentence, the rate of interest on any financing shall be determined by treating interest to the extent of government subsidies as not payable.

(4) Failure to fully repay.

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

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

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

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

(B) Applicable portion. For purposes of subparagraph (A) , the term “applicable portion” means the aggregate decrease in the credits allowed to a taxpayer under section 38 for all prior taxable

years which would have resulted if the eligible basis of the building were reduced by the amount of financing which does not meet requirements of paragraph (2)(D) .

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

(l) Certifications and other reports to secretary.

(1) Certification with respect to 1st year of credit period.
Following the close of the 1st taxable year in the credit period with respect to any qualified low-income building, the taxpayer shall certify to the Secretary (at such time and in such form and in such manner as the Secretary prescribes)—

(A) the taxable year, and calendar year, in which such building was placed in service,

(B) the adjusted basis and eligible basis of such building as of the close of the 1st year of the credit period,

(C) the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under subsection (h) ,

(D) the election made under subsection (g) with respect to the qualified low-income housing project of which such building is a part, and

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

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

(2) Annual reports to the Secretary.
The Secretary may require taxpayers to submit an information return (at such time and in such form and manner as the Secretary prescribes) for each taxable year setting forth—

(A) the qualified basis for the taxable year of each qualified low-income building of the taxpayer,

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

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

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

(3) Annual reports from housing credit agencies.
Each agency which allocates any housing credit amount to any building for any calendar year shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual report specifying—

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

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

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

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

(m) Responsibilities of housing credit agencies.

(1) Plans for allocation of credit among projects.

(A) In general. Notwithstanding any other provision of this section , the housing credit dollar amount with respect to any building shall be zero unless—

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

(ii) such agency notifies the chief executive officer (or the equivalent) of the local jurisdiction within which the building is located of such project and provides such

individual a reasonable opportunity to comment on the project,

(iii) a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project is conducted before the credit allocation is made and at the developer's expense by a disinterested party who is approved by such agency, and

(iv) a written explanation is available to the general public for any allocation of a housing credit dollar amount which is not made in accordance with established priorities and selection criteria of the housing credit agency.

(B) Qualified allocation plan. For purposes of this paragraph , the term “qualified allocation plan” means any plan—

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

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

(I) projects serving the lowest income tenants,

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

(III) projects which are located in qualified census tracts (as defined in subsection (d)(5)(C)) and the development of which contributes to a concerted community revitalization plan, and

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

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

(i) project location,

(ii) housing needs characteristics,

(iii) project characteristics, including whether the project includes the use of existing housing as part of a community revitalization plan,

(iv) sponsor characteristics,

(v) tenant populations with special housing needs,

(vi) public housing waiting lists,

(vii) tenant populations of individuals with children, and

(viii) projects intended for eventual tenant ownership.

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

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

(A) In general. The housing credit dollar amount allocated to a project shall not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period.

(B) Agency evaluation. In making the determination under subparagraph (A) , the housing credit agency shall consider—

(i) the sources and uses of funds and the total financing planned for the project,

(ii) any proceeds or receipts expected to be generated by reason of tax benefits,

(iii) the percentage of the housing credit dollar amount used for project costs other than the cost of intermediaries, and

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

Clause (iii) shall not be applied so as to impede the development of projects in hard-to-develop areas. Such a determination shall not be construed to be a representation or warranty as to the feasibility or viability of the project.

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

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

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

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

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

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

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

(n) Regulations.
The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section , including regulations—

(1) dealing with—

(A) projects which include more than 1 building or only a portion of a building,

(B) buildings which are placed in service in portions,

(2) providing for the application of this section to short taxable years,

(3) preventing the avoidance of the rules of this section , and

(4) providing the opportunity for housing credit agencies to correct administrative errors and omissions with respect to allocations and record keeping within a reasonable period after their discovery, taking into account the availability of regulations and other administrative guidance from the Secretary.

Section 10

IRS Forms
8609 and 8609 Schedule A

Form **8609**
(Rev. December 2016)
Department of the Treasury
Internal Revenue Service

Low-Income Housing Credit Allocation and Certification

▶ **Information about Form 8609 and its separate instructions is at *www.irs.gov/form8609.***

OMB No. 1545-0988

Part I Allocation of Credit

Check if: ☐ Addition to Qualified Basis ☐ Amended Form

A Address of **building** (do not use P.O. box) (see instructions)	**B** Name and address of **housing credit agency**
C Name, address, and TIN of **building owner** receiving allocation TIN ▶	**D** Employer identification number of agency **E** Building identification number (BIN)

1a	Date of allocation ▶ _____ **b** Maximum housing credit dollar amount allowable	**1b**	
2	Maximum applicable credit percentage allowable (see instructions)	**2**	%
3a	Maximum qualified basis	**3a**	
b	Check here ▶ ☐ if the eligible basis used in the computation of line 3a was increased under the high-cost area provisions of section 42(d)(5)(B). Enter the percentage to which the eligible basis was increased (see instructions)	**3b**	1 ___ ___ %
4	Percentage of the aggregate basis financed by tax-exempt bonds. (If zero, enter -0-.)	**4**	%
5	Date building placed in service ▶ _____		

6 Check the boxes that describe the allocation for the building (check those that apply):

a ☐ Newly constructed and federally subsidized **b** ☐ Newly constructed and **not** federally subsidized **c** ☐ Existing building

d ☐ Sec. 42(e) rehabilitation expenditures federally subsidized **e** ☐ Sec. 42(e) rehabilitation expenditures **not** federally subsidized

f ☐ Allocation subject to nonprofit set-aside under sec. 42(h)(5)

Signature of Authorized Housing Credit Agency Official—Completed by Housing Credit Agency Only

Under penalties of perjury, I declare that the allocation made is in compliance with the requirements of section 42 of the Internal Revenue Code, and that I have examined this form and to the best of my knowledge and belief, the information is true, correct, and complete.

▶	▶	▶
Signature of authorized official	Name (please type or print)	Date

Part II First-Year Certification—Completed by Building Owners with respect to the First Year of the Credit Period

7	Eligible basis of building (see instructions)	**7**	
8a	Original qualified basis of the building at close of first year of credit period	**8a**	
b	Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)?	☐ Yes	☐ No
9a	If box 6a or box 6d is checked, do you elect to reduce eligible basis under section 42(i)(2)(B)?	☐ Yes	☐ No
b	For market-rate units above the average quality standards of low-income units in the building, do you elect to reduce eligible basis by disproportionate costs of non-low-income units under section 42(d)(3)(B)? ▶	☐ Yes	☐ No

10 Check the appropriate box for each election.

Caution: *Once made, the following elections are irrevocable.*

a Elect to begin credit period the first year after the building is placed in service (section 42(f)(1)) ▶ ☐ Yes ☐ No

b Elect **not** to treat large partnership as taxpayer (section 42(j)(5)) ▶ ☐ Yes

c Elect minimum set-aside requirement (section 42(g)) (see instructions) ☐ 20-50 ☐ 40-60 ☐ 25-60 (N.Y.C. only)

d Elect deep rent skewed project (section 142(d)(4)(B)) (see instructions) ☐ 15-40

Under penalties of perjury, I declare that I have examined this form and accompanying attachments, and to the best of my knowledge and belief, they are true, correct, and complete.

▶	▶	▶
Signature	Taxpayer identification number	Date
▶ Name (please type or print)	▶ First year of the credit period	

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 63981U Form **8609** (Rev. 12-2016)

Instructions for Form 8609

(Rev. December 2016)

Department of the Treasury
Internal Revenue Service

Low-Income Housing Credit Allocation and Certification

Section references are to the Internal Revenue Code unless otherwise noted.

Future Developments

For the latest information about developments related to Form 8609 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/form8609*.

Reminder

The 9% minimum applicable percentage of section 42(b)(2) has been made permanent for certain buildings placed in service after July 30, 2008. For details, see the instructions for Part I.

General Instructions

Purpose of Form

Owners of residential low-income rental buildings are allowed a low-income housing credit for each qualified building over a 10-year credit period. Form 8609 can be used to obtain a housing credit allocation from the housing credit agency. A separate Form 8609 must be issued for each building in a multiple building project. Form 8609 is also used to certify certain information.

Housing credit agency. This is any state or local agency authorized to make low-income housing credit allocations within its jurisdiction.

Building identification number (BIN). This number is assigned by the housing credit agency. The BIN initially assigned to a building must be used for any allocation of credit to the building that requires a separate Form 8609 (see *Multiple Forms 8609*, later). For example, rehabilitation expenditures treated as a separate new building shouldn't have a separate BIN if the building already has one. Use the number first assigned to the building.

Allocation of credit. For an owner to claim a low-income housing credit on a building (except as explained under *Tax-exempt bonds*, later), the housing credit agency must make an allocation of the credit by the close of the calendar year in which the building is placed in service, unless:

1. The allocation is the result of an advance binding commitment by the credit agency made not later than the close of the calendar year in which the building is placed in service (see section 42(h)(1)(C));

2. The allocation relates to an increase in qualified basis (see section 42(h)(1)(D));

3. The allocation is made for a building placed in service no later than the second calendar year following the calendar year in which the allocation is made if the building is part of a project in which the taxpayer's basis is more than 10% of the project's reasonably expected basis as of the end of that second calendar year; or

4. The allocation is made for a project that includes more than one building if:

a. The allocation is made during the project period,

b. The allocation applies only to buildings placed in service during or after the calendar year in which the allocation is made, and

c. Each building in the project to which the allocation applies is identified by a separate building identification number (BIN).

Regarding 3. and 4., (carryover allocations) see sections 42(h)(1)(E) and 42(h)(1)(F) and Regulations section 1.42-6.

The agency can only make an allocation to a building located within its geographical jurisdiction. Once an allocation is made, the credit is allowable for all years during the 10-year credit period. A separate Form 8609 must be completed for each building to which an allocation of credit is made.

Multiple Forms 8609. Allocations of credit in separate calendar years require separate Forms 8609. Also, when a building receives separate allocations for acquisition of an existing building and for rehabilitation expenditures, a separate Form 8609 must be completed for each credit allocation.

Tax-exempt bonds. No housing credit allocation is required for any portion of the eligible basis of a qualified low-income building that is financed with tax-exempt bonds taken into account for purposes of the volume cap under section 146 if principal payments on the financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide the financing or the financing is refunded as described in section 146(i)(6). An allocation isn't needed when 50% or more of the aggregate basis of the building and the land on which the building is located (defined below) is financed with tax-exempt bonds described in the preceding sentence. However, the owner still must get a Form 8609 from the appropriate housing credit agency (with the applicable items completed, including an assigned BIN).

Land on which the building is located. This includes only land that is functionally related and subordinate to the qualified low-income building. (See Regulations sections 1.103-8(a)(3) and 1.103-8(b)(4)(iii) for the meaning of "functionally related and subordinate.")

Filing Requirement

Housing credit agency. Complete and sign Part I of Form 8609 and make copies of the form. Submit a copy with Form 8610, Annual Low-Income Housing Credit Agencies Report, and keep a copy for the records. The agency must send the original, signed Form 8609 (including instructions) to the building owner.

Building owner. You must make a one-time submission of Form 8609 to the Low-Income Housing Credit (LIHC) Unit at the IRS Philadelphia campus address below. After making a copy of the completed original Form 8609, file the original of the form with the unit no later than the due date (including extensions) of your first tax return with which you are filing Form 8609-A, Annual Statement for Low-Income Housing Credit.

Where to file Form 8609. Send the properly completed and signed form(s) to:

Department of the Treasury
Internal Revenue Service Center
Philadelphia, PA 19255-0549

Note. The housing credit agency may require you to submit a copy of Form 8609 with a completed Part II to the agency. You should contact the agency to obtain agency filing requirements.

Also, file Form 8609-A for each year of the 15-year compliance period. The credit is claimed on Form 8586, Low-Income Housing Credit. See the forms for filing instructions.

Building Owner's Recordkeeping

Keep the following items in your records for three years after the due date (including extensions) of the owner's tax return for the tax year that includes the end of the 15-year compliance period.

- A copy of the original Form 8609 received from the housing agency and all related Forms 8609-A (or predecessor Schedules A (Form 8609)), Forms 8586, and any Forms 8611, Recapture of Low-Income Housing Credit.
- If the maximum applicable credit percentage allowable on line 2 reflects an election under section 42(b)(1)(ii), (or former section 42(b)(2)(A)(ii), for buildings placed in service before July 31, 2008), a copy of the election statement.
- If the binding agreement specifying the housing credit dollar amount is contained in a separate document, a copy of the binding agreement.
- If the housing credit dollar amount allocated on line 1b reflects an allocation made under section 42(h)(1)(E) or section 42(h)(1)(F), a copy of the allocation document.

Specific Instructions

Part I—Allocation of Credit

Completed by Housing Credit Agency Only

Addition to qualified basis. Check this box if an allocation relates to an increase in qualified basis under section 42(f)(3). Enter only the housing credit dollar amount for the increase. Don't include any portion of the original qualified basis when determining this amount.

Amended form. Check this box if this form amends a previously issued form. Complete all entries and explain the reason for the amended form. For example, if there is a change in the amount of initial allocation before the close of the calendar year, file an amended Form 8609 instead of the original form.

Item A. Identify the building for which this Form 8609 is issued when there are multiple buildings with the same address (e.g., BLDG. 6 of 8).

Line 1a. Generally, where Form 8609 is the allocating document, the date of the allocation is the date the Form 8609 is completed, signed, and dated by an authorized official of the housing credit agency during the year the building is placed in service.

However, if an allocation is made under section 42(h)(1)(E) or 42(h)(1)(F), the date of allocation is the date the authorized official of the housing credit agency completes, signs, and dates the section 42(h)(1)(E) or 42(h)(1)(F) document used to make the allocation. If no allocation is required (i.e., 50% or greater tax-exempt bond financed building), leave line 1a blank.

Line 1b. Enter the housing credit dollar amount allocated to the building for each year of the 10-year credit period. The amount should equal the percentage on line 2 multiplied by the amount on line 3a. The housing credit agency is required to allocate only the amount necessary to assure project feasibility. To accomplish this, the agency can, to the extent permitted by the Code and regulations, lower the percentage on line 2 and the amount on line 3a. See the instructions for these lines for the limits that apply. For tax-exempt bond projects for which no allocation is required, enter the housing credit dollar amount allowable under section 42(h)(4).

Line 2. The maximum applicable credit percentage allowable is determined in part by the date the building was placed in service. Follow the instructions pertaining to the date the building was placed in service.

Enter the maximum applicable credit percentage allowable to the building for the month the building was placed in service or, if applicable, for the month determined under section 42(b)(1)(ii). This percentage may be less than the applicable percentage published by the IRS.

CAUTION *A minimum applicable credit percentage of 9% is in effect for new non-federally subsidized buildings placed in service after July 30, 2008. The 9% minimum also applies to new non-federally subsidized buildings even if the taxpayer made an irrevocable election under former section 42(b)(1)(A)(ii). If this circumstance applies, don't enter less than 9% on line 2. See section 42(m) and Regulations section 1.42-8(a)(4).*

If an election was made under section 42(b)(1)(A)(ii) to use the applicable percentage for a month other than the month in which a building is placed in service, the requirements of Regulations section 1.42-8 must be met. The agency must keep a copy of the binding agreement. The applicable percentage is published monthly in the Internal Revenue Bulletin. For new buildings that aren't federally subsidized under section 42(i)(2)(A), use the applicable percentage for the 70% present value credit, but don't enter less than 9%, unless the housing credit agency determines that a lesser amount is necessary to assure project feasibility. For new buildings that are federally subsidized, or existing buildings, use the applicable percentage for the 30% present value credit. See the instructions for line 6 for the definition of "federally subsidized," and the time period for which the definition applies. A taxpayer may elect under section 42(i)(2)(B) to reduce eligible basis by the proceeds of any tax-exempt obligation in order to obtain the higher credit percentage.

For allocations to buildings for additions to qualified basis under section 42(f)(3), don't reduce the applicable percentage even though the building owner may only claim a credit based on two-thirds of the credit percentage allocated to the building.

Line 3a. Enter the maximum qualified basis of the building. In computing qualified basis, the housing credit agency should use only the amount of eligible basis necessary to result in a qualified basis which, when multiplied by the percentage on line 2, equals the credit amount on line 1b. However, the housing credit agency isn't required to reduce maximum qualified basis and can lower the maximum

applicable percentage on line 2. To compute qualified basis, multiply the eligible basis of the qualified low-income building by the smaller of:

- The fractional amount of low-income units to all residential rental units (the “unit fraction”) or
- The fractional amount of floor space of the low-income units to the floor space of all residential rental units (the “floor space fraction”).

Generally, the term "low-income unit" means any unit in a building if the unit is rent-restricted and the individuals occupying the unit meet the income limitation applicable to the project of which the building is a part. See section 42(g). Generally, a unit isn't treated as a low-income unit unless it's suitable for occupancy and used other than on a transient basis. Section 42(i)(3) provides for certain exceptions (e.g., units that provide for transitional housing for the homeless may qualify as low-income units). See sections 42(i)(3) and 42(c)(1)(E) for more information.

Except as explained in the instructions for line 3b below, the eligible basis for a new building is its adjusted basis as of the close of the first tax year of the credit period. For an existing building, the eligible basis is its acquisition cost plus capital improvements through the close of the first tax year of the credit period. See the instructions for line 3b and section 42(d) for other exceptions and details.

Line 3b. Special rule to increase basis for buildings in certain high-cost areas. If the building is located in a high-cost area (i.e., “qualified census tract” or “difficult development area”), the eligible basis may be increased as follows.

- For new buildings, the eligible basis may be up to 130% of such basis determined without this provision.
- For existing buildings, the rehabilitation expenditures under section 42(e) may be up to 130% of the expenditures determined without regard to this provision.

Enter the percentage to which eligible basis was increased. For example, if the eligible basis was increased to 120%, enter “120.”

Section 42(d)(5)(B)(v) permits a similar increase in basis for any non-federally subsidized building designated by the state agency to need the basis increase to be financially feasible as part of a qualified low-income housing project.

TIP *See section 42(d)(5)(B) for definitions of a qualified census tract and a difficult development area, and for other details.*

Note. Before increasing eligible basis, the eligible basis must be reduced by any federal subsidy which the taxpayer elects to exclude from eligible basis. For buildings placed in service after July 30, 2008, the eligible basis can't include any costs financed with federal grant proceeds.

Line 4. Enter the percentage of the aggregate basis of the building and land on which the building is located that is financed by certain tax-exempt bonds. If this amount is zero, enter -0-. Don't leave this line blank.

Line 5. The placed-in-service date for a residential rental building is the date the first unit in the building is ready and available for occupancy under state or local law. Rehabilitation expenditures treated as a separate new building under section 42(e) are placed in service at the close of any 24-month period over which the expenditures are aggregated, whether or not the building is occupied during the rehabilitation period.

Note. The placed-in-service date for an existing building is determined separately from the placed-in-service date of rehabilitation expenditures treated as a separate new building.

Line 6. Not more than 90% of the state housing credit ceiling for any calendar year can be allocated to projects other than projects involving qualified nonprofit organizations. A qualified nonprofit organization must own an interest in the project (directly or through a partnership) and materially participate (within the meaning of section 469(h)) in the development and operation of the project throughout the compliance period. See section 42(h)(5) for more details.

Generally, no credit is allowable for acquisition of an existing building unless substantial rehabilitation is done. See sections 42(d)(2)(B)(iv) and 42(f)(5) that were in effect on the date the allocation was made. Don't issue Form 8609 for acquisition of an existing building unless substantial rehabilitation under section 42(e) is placed in service.

Lines 6a and 6d. A building is treated as federally subsidized if at any time during the tax year or prior tax year there is outstanding any tax-exempt bond financing, the proceeds of which are used (directly or indirectly) for the building or its operation. If a building is federally subsidized, then box 6a or 6d must be checked regardless of whether the taxpayer has informed the housing credit agency that the taxpayer intends to make the election under section 42(i)(2)(B) to reduce eligible basis by the proceeds of any tax-exempt obligation.

Part II—First-Year Certification

Completed by Building Owner With Respect to the First Year of the Credit Period

CAUTION *By completing Part II, you are certifying the date the building is placed in service corresponds to the date on line 5. If the Form 8609 issued to you contains the wrong date or no date, obtain a new or amended Form 8609 from the housing credit agency.*

Line 7. Enter the eligible basis (in dollars) of the building. Eligible basis doesn't include the cost of land. Determine eligible basis at the close of the first year of the credit period (see sections 42(f)(1), 42(f)(5), and 42(g)(3)(B)(iii) for determining the start of the credit period).

For new buildings, the eligible basis is generally the cost of construction or rehabilitation expenditures incurred under section 42(e).

For existing buildings, the eligible basis is the cost of acquisition plus rehabilitation expenditures not treated as a separate new building under section 42(e) incurred by the close of the first year of the credit period.

If the housing credit agency has entered an increased percentage in Part I, line 3b, multiply the eligible basis by the increased percentage and enter the result.

Residential rental property may qualify for the credit even though part of the building in which the residential rental units are located is used for commercial use. Don't include the cost of the nonresident rental property. However, you may generally include the basis of common areas or tenant facilities, such as swimming pools or parking areas, provided there is no separate fee for the use of these facilities and they are made available on a comparable basis to all tenants in the project.

The eligible basis shall not include any costs paid by the proceeds of a federal grant. Also, reduce the eligible basis by the entire basis allocable to non-low-income units that are above average quality standard of the low-income units in the building. You may, however, include a portion of the basis of these non-low-income units if the cost of any of these units doesn't exceed by more than 15% the average cost of all low-income units in the building, and you elect to exclude this excess cost from the eligible basis by checking the "Yes" box for line 9b. See section 42(d)(3).

You may elect to reduce the eligible basis by the proceeds of any tax-exempt obligation to obtain a higher credit percentage. To make this election, check the "Yes" box in Part II, line 9a. Reduce the eligible basis by the obligation proceeds before entering the amount on line 7. You must reduce the eligible basis by such obligation proceeds before multiplying the eligible basis by the increased percentage in Part I, line 3b.

Line 8a. Multiply the eligible basis of the building shown on line 7 by the smaller of the unit fraction or the floor space fraction as of the close of the first year of the credit period and enter the result on line 8a. Low-income units are units occupied by qualifying tenants, while residential rental units are all units, whether or not occupied. See the instructions for Part I, line 3a.

Line 8b. Each building is considered a separate project under section 42(g)(3)(D) unless, before the close of the first calendar year in the project period (defined in section 42(h)(1)(F)(ii)), each building that is (or will be) part of a multiple building project is identified by attaching the statement described below.

The statement must be attached to this Form 8609 and include:

- The name and address of the project and each building in the project,
- The BIN of each building in the project,
- The aggregate credit dollar amount for the project, and
- The credit allocated to each building in the project.

CAUTION *Notwithstanding a checked "Yes" box on line 8b, failure to attach a statement providing the above required information will result in each building being considered a separate project under section 42(g)(3)(D). The minimum set-aside requirement (see the instructions for line 10c) is a project-based test.*

Two or more qualified low-income buildings may be included in a multiple building project only if they:

- Are located on the same tract of land (including contiguous parcels), unless all of the dwelling units in all of the buildings being aggregated in the multiple building project are rent restricted units (see section 42(g)(7));
- Are owned by the same person for federal tax purposes;
- Are financed under a common plan of financing; and
- Have similarly constructed housing units.

A qualified low-income building includes residential rental property that is an apartment building, a single-family dwelling, a town house, a row house, a duplex, or a condominium.

Line 9a. Follow the instructions that apply for the date the building was placed in service.

You may elect to reduce the eligible basis by the proceeds of any tax-exempt obligation and claim the 70% present value credit on the remaining eligible basis. A minimum applicable percentage of 9% is in effect for new non-federally subsidized buildings placed in service after July 30, 2008, unless the housing credit agency determines a lesser amount is necessary to assure project feasibility. However, if you make this election, you may not claim the 30% present value credit on the portion of the basis that was financed with the tax-exempt obligation.

Line 9b. See the instructions for Part II, line 7.

Line 10a. You may elect to begin the credit period in the tax year after the building is placed in service. Once made, the election is irrevocable.

Note. Section 42(g)(3)(B)(iii) provides special rules for determining the start of the credit period for certain multiple building projects.

Line 10b. Partnerships with 35 or more partners are treated as the taxpayer for purposes of recapture unless an election is made not to treat the partnership as the taxpayer. Check the "Yes" box if you don't want the partnership to be treated as the taxpayer for purposes of recapture. Once made, the election is irrevocable.

Line 10c. You must meet the minimum set-aside requirements under section 42(g)(1) for the project by electing one of the following tests.

- **20-50 Test.** Twenty percent (20%) or more of the residential units in the project must be both rent restricted and occupied by individuals whose income is 50% or less of the area median gross income or
- **40-60 Test.** Forty percent (40%) or more of the residential units in the project must be both rent restricted and occupied by individuals whose income is 60% or less of the area median gross income.

Note. Owners of buildings in projects located in New York City may not use the 40-60 Test. Instead, they may use the **25-60 Test**. Under the 25-60 Test, 25% or more of the residential units in the project must be both rent restricted and occupied by individuals whose income is 60% or less of the area median gross income (see section 142(d)(6)).

Once made, the election is irrevocable.

Rural projects. For purposes of the 20-50, 40-60, and 25-60 tests, "national non-metropolitan median income" will be used for determining income if it exceeds "area median gross income," but only for determinations of income made after July 30, 2008, and buildings with an allocation of credit. See section 42(i)(8) for details.

CAUTION *The minimum set-aside requirement is a project-based test and must be met by the close of the first year of the credit period in order to claim any credit for the first year or for any subsequent years.*

Line 10d. The deep rent skewed 15-40 election isn't an additional test for satisfying the minimum set-aside requirements of section 42(g)(1). The 15-40 test is an election that relates to the determination of a low-income tenant's income. Generally, a continuing resident's income may increase up to 140% of the applicable income limit (50% or less or 60% or less of the area median gross income (or, when applicable, national non-metropolitan median income) under the minimum set-aside rules described earlier in line 10c). When the deep rent skewed election is made, the income of a continuing resident may increase up to 170% of the applicable income limit. If this election is made, at least 15% of all low-income units in the

project must be occupied at all times during the compliance period by tenants whose income is 40% or less of the area median gross income (or, when applicable, national non-metropolitan median income). A deep rent skewed project itself must meet the requirements of section 142(d)(4)(B). Once made, the election is irrevocable.

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. Claiming this credit is voluntary; however, if you do claim the credit, sections 42, 6001, and 6011 require you to provide this information. Section 6109 requires you to provide your taxpayer identifying number (SSN, EIN, or ITIN). We need this information to ensure that you are complying with the revenue laws and to allow us to figure and collect the right amount of tax. We may disclose this information to the Department of Justice for civil or criminal litigation, and to cities, states, the District of Columbia, and U.S. commonwealths and possessions for use in administering their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism. Failure to provide this information may delay or prevent processing your claim. Providing false information may subject you to penalties.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law.

The time needed to complete and file the form will vary depending on individual circumstances. The estimated average time is:

Learning about the law or the form	4 hr., 10 min.
Recordkeeping	10 hr., 45 min.
Preparing and sending the form to the IRS	4 hr., 31 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making these forms simpler, we would be happy to hear from you. You can send your comments from *www.irs.gov/formspubs*. Click on “More Information” and then on “Give us feedback.” Or you can send your comments to the Internal Revenue Service, Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC, 20224. Do not send the tax form to this office. Instead, see *Filing Requirement*, earlier.

Form **8609-A**
(Rev. December 2008)
Department of the Treasury
Internal Revenue Service

Annual Statement for Low-Income Housing Credit

▶ **File with owner's federal income tax return.**
▶ **See separate instructions.**

OMB No. 1545-0988

Attachment Sequence No. **36**

Name(s) shown on return | **Identifying number**

Part I Compliance Information

		Yes	No
A	Building identification number (BIN) ▶		
B	This Form 8609-A is for (check the box) ▶ a newly constructed or existing building ☐ section 42(e) rehabilitation expenditures ☐		
C	Do you have in your records the original Form 8609 (or a copy thereof) signed and issued by the housing credit agency for the building in **A**? . . . . . If "No," see the instructions and stop here—do not go to Part II.		
D	Did the building in **A** qualify as a part of a qualified low-income housing project and meet the requirements of section 42 as of the end of the tax year for which this form is being filed? . . . . . If "No," see the instructions and stop here—do not go to Part II.		
E	Was there a decrease in the qualified basis of the building in **A** for the tax year for which this form is being filed? . . . . . If "Yes," see the instructions. If "No," and the entire credit has been claimed in prior tax years, stop here—do not go to Part II.		

Part II Computation of Credit

1	Eligible basis of building	**1**	
2	Low-income portion (smaller of unit fraction or floor space fraction) (if first year of the credit period, see instructions)	**2**	.
3	Qualified basis of low-income building. Multiply line 1 by line 2 (see instructions for exceptions)	**3**	
4	Part-year adjustment for disposition or acquisition during the tax year	**4**	
5	Credit percentage	**5**	.
6	Multiply line 3 or line 4 by the percentage on line 5	**6**	
7	Additions to qualified basis, if any	**7**	
8	Part-year adjustment for disposition or acquisition during the tax year	**8**	
9	Credit percentage. Enter one-third of the percentage on line 5	**9**	.
10	Multiply line 7 or line 8 by the percentage on line 9	**10**	
11	Section 42(f)(3)(B) modification	**11**	
12	Add lines 10 and 11	**12**	
13	Credit for building before line 14 reduction. Subtract line 12 from line 6	**13**	
14	Disallowed credit due to federal grants (see instructions)	**14**	
15	Credit allowed for building for tax year. Subtract line 14 from line 13, but do not enter more than the amount shown on Form 8609, Part I, line 1b	**15**	
16	Taxpayer's proportionate share of credit for the year (see instructions)	**16**	
17	Adjustments for deferred first-year credit (see instructions)	**17**	
18	Taxpayer's credit. Combine lines 16 and 17. Enter here and on Form 8586 (see instructions)	**18**	

Instructions for Form 8609-A

Department of the Treasury
Internal Revenue Service

(Rev. December 2008)

Annual Statement for Low-Income Housing Credit

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

What's New

If you disposed of a building or a certain interest therein, it is no longer necessary in certain circumstances to file Form 8693, Low-Income Housing Credit Disposition Bond, to prevent recapture of the low-income housing credit. If you have already filed Form 8693, you can make an election to discontinue the maintenance of the established account. See *Recapture and building dispositions* for details.

The method used to calculate basis reductions for certain buildings has changed. See *Basis reductions for buildings placed in service after July 30, 2008*, for details.

The method used to calculate the disallowed credit due to federal grants has changed for buildings placed in service after July 30, 2008. See the instructions for line 14 for details.

For buildings placed in service after December 31, 2007, the credit is no longer limited by the alternative minimum tax rules. Form 8586, Low-Income Housing Credit, has been revised to reflect this change. See the instructions for line 18 for information on reporting the credit on Form 8586.

Note. Some of the line numbers on the March 1991 and November 2003 revisions of Form 8609, Low-Income Housing Credit Allocation Certification, and December 2005, December 2006, December 2007, and December 2008 revisions of Form 8609, Low-Income Housing Credit Allocation and Certification, differ from other revisions. In these cases, the line references are shown in parentheses in these instructions.

Purpose of Form

Form 8609-A is filed by a building owner to report compliance with the low-income housing provisions and calculate the low-income housing credit. Form 8609-A must be filed by the building owner for each year of the 15-year compliance period. File one Form 8609-A for the allocation(s) for the acquisition of an existing building and a separate Form 8609-A for the allocation(s) for rehabilitation expenditures.

If the building owner is a partnership, S corporation, estate, or trust (pass-through entity), the entity will complete Form 8609 and Form 8609-A. The entity will attach Form 8609-A to its tax return. If you are a partner, shareholder, or beneficiary in the pass-through entity that owns the building, file only Form 8586, Low-Income Housing Credit, to claim the credit using the information that the entity furnishes you on Schedule K-1.

Recapture of Credit

If the qualified basis of the building has decreased from the qualified basis at the close of the previous tax year, you may have to recapture parts of the credits allowed in previous years. See Form 8611, Recapture of Low-Income Housing Credit.

Recapture and building dispositions. The disposition of a building, or an interest therein, will generate the recapture of the credit. You can prevent the recapture if you follow the procedures below, relative to the date of the disposition of the building or the interest therein.

Building dispositions before July 31, 2008. Disposing of a building or an interest therein during the tax year will generate credit recapture, unless you timely post a satisfactory bond or pledge eligible U.S. Treasury securities as collateral. For details on the rules for posting or pledging, see Rev. Rul. 90-60, 1990-2 C.B. 3, and Rev. Proc. 99-11, 1991-1 C.B. 275.

Note. You may discontinue maintaining a bond or pledging eligible U.S. Treasury securities by making the election described in Rev. Proc. 2008-60, 2008-43 I.R.B. 1006, and if it is reasonably expected that the building will continue to be operated as a qualified low-income building for the remainder of the building's compliance period. See Rev. Proc. 2008-60 for the details on making the election.

Building dispositions after July 30, 2008. Disposing of a building or an interest therein will generate a credit recapture, unless it is reasonably expected that the building will continue to be operated as a qualified low-income building for the remainder of the building's compliance period.

See section 42(j) for more information.

Sale of Building

Upon a change of ownership, the seller should give the new owner a copy of the Form 8609 (Parts I and II complete). This form allows the new owner to substantiate the credit.

Specific Instructions

Part I—Compliance Information

Item A. Enter the building identification number (BIN) from Part I, item E of Form 8609.

Item B. You need to file one Form 8609-A for a newly constructed or existing building. You need to file a separate Form 8609-A for section 42(e) rehabilitation expenditures because such expenditures are treated as creating a new building.

Item C. In order to claim the credit, you must have an original, signed Form 8609 (or copy thereof) issued by a housing credit agency assigning a BIN for the building. This applies even if no allocation is required (as in the case of a building financed with tax-exempt bonds). Check "Yes" to certify that you have the required Form 8609 in your records.

CAUTION *Any building owner claiming a credit without receiving a completed Form 8609 that is signed and dated by an authorized official of the housing credit agency and submitting the completed Form 8609 (Part I and Part II) to the IRS is subject to having the credit disallowed.*

Item D. If "No," stop here and see Form 8611 to find out if you have to recapture part of the credit allowed in prior years.

Item E. If "Yes," see the instructions for line 2 to figure the reduced qualified basis. Also, see Form 8611 to find out if you have to recapture part of the credit allowed in prior years.

If "No," and the entire credit has been claimed in prior tax years (generally this can occur after the 11th year for which the credit has been claimed for the building), do not complete Part II.

Part II—Computation of Credit

Line 1. Generally, the eligible basis of a building for its entire 15-year compliance period is the amount of eligible basis entered on Form 8609, line 7b (Part II, line 1b, on the 1991 revision; line 7 on the 2003, 2005, 2006, 2007, and 2008 revisions).

Basis increases for buildings in certain high-cost areas. In order to increase the credit for buildings in certain high-cost areas, the housing credit agency may increase the eligible basis of buildings located in these areas (after adjustments, if any, for federal subsidies and grants). The agency may make this increase under the high cost area provisions of section 42(d)(5)(B). For buildings placed in service before July 31, 2008, the high cost area provisions under former section 42(d)(5)(C) apply.

Gulf Opportunity (GO) Zone, Rita GO Zone, and Wilma GO Zone. The housing credit agency may increase the eligible basis of buildings in these specific zones if the buildings receive allocations in 2006, 2007, or 2008 and the buildings are placed in service during the period beginning on January 1, 2006, and ending on December 31, 2010. See section 1400N(c)(3) for more information. See Pub. 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma,* for a list of the counties and parishes in these specific zones.

Note. This increase cannot cause the credit on line 15 to exceed the credit amount allocated on line 1b, Part I, of Form 8609.

Basis reductions for buildings placed in service before July 31, 2008. The amount of eligible basis entered on Form

8609 does not include the cost of land or the amount of any federal grant received for the building during the first year of the credit period. Do not reduce the eligible basis on line 1 by the amounts of any federal grants received after the first year of the credit period. The calculation for line 14 will reduce the credit by the amount of any federal grants received during the compliance period that did not reduce the eligible basis during the first year of the credit period.

For more details on determining eligible basis, see the instructions for Form 8609, line 7b (Part II, line 1b, on the 1991 revision; line 7 on the 2003, 2005, 2006, 2007, and 2008 revisions).

Basis reductions for buildings placed in service after July 30, 2008. The amount of eligible basis entered on Form 8609 does not include the cost of land or the amount of any costs financed with the proceeds of a federally funded grant. Do not reduce the eligible basis on line 1 by the amounts of any federal grants received after the first year of the credit period. The calculation for line 14 will reduce the credit for any costs financed with the proceeds of a federal grant.

For more details on determining eligible basis, see the instructions for Form 8609, line 7, 2008 revision.

Line 2. Only the portion of the basis on line 1 attributable to the low-income rental units in the building at the close of the tax year qualifies for the credit. This is the smaller of the fractional amount of low-income units to all residential rental units (the "unit fraction") or the fractional amount of floor space of the low-income units to the floor space of all residential rental units (the "floor space fraction"). This fraction must be shown on line 2 as a decimal carried out to at least four places (for example, $^{50}/_{100}$ = .5000). Low-income units are units occupied by qualifying tenants, while residential rental units are all units, whether or not occupied.

Generally, a unit is not treated as a low-income unit unless it is suitable for occupancy, used other than on a transient basis, and occupied by qualifying tenants. Section 42(i)(3) provides for certain exceptions (for example, units that provide transitional housing for the homeless may qualify as low-income units). See section 42(i)(3) for more details. Also see section 42(g)(2)(D) regarding the available unit rule and Regulations section 1.42-5(c)(1)(ix) regarding the vacant unit rule.

If you dispose of the building, or your entire interest in the building, before the close of the tax year, the low-income portion must be determined on the date you disposed of the building. If you dispose of less than your entire interest in the building, the low-income portion must be determined at the close of the tax year.

First-year modified percentage. For the first year of the credit period, you must use a modified percentage on line 2 to reflect the average portion of a 12-month period that the units in a building were occupied by low-income individuals. Figure the low-income portion as of the end of each full month that the building was in service during the year. Add these percentages together and divide by 12. Enter the result on line 2. For example, if a building was in service for the last 3 full months of your tax year, and was half occupied by low-income tenants as of the end of each of those 3 months, then assuming the smaller fractional amount was the unit fraction, you would enter .1250 on line 2 ([.5 + .5 + .5] ÷ 12 = .1250).

This first year adjustment does not affect the amount of qualified basis on which the credit is claimed in the next 9 tax years. In general, the credit is claimed in those years by reference to the qualified basis at the close of each tax year.

Because the first year credit is not determined solely by reference to the qualified basis at the close of the year, any reduction in credit resulting from the application of the first year adjustment may be claimed in the 11th year. See the instructions for line 17.

Line 3. Generally, multiply line 1 by line 2 to figure the portion of the eligible basis of the building attributable to the low-income residential rental units.

Imputed qualified basis of zero. However, the qualified basis of the building (line 3) is zero if any of the following conditions apply.

- The minimum set-aside requirement elected for the project on Form 8609, line 10c (Part II, line 5c, on the 1991 revision), is not met, or the entire building is out of compliance with the requirements under section 42.
- The deep rent skewed test (15-40 test) elected for the project on Form 8609, line 10d (Part II, line 5d, on the 1991 revision), is violated. The 15-40 test is not an additional test for satisfying the minimum set-aside requirements of section 42(g)(1). The 15-40 test is an election that relates to the determination of a low-income tenant's income. If this test is elected, at least 15% of all low-income units in the project must be occupied at all times during the compliance period by tenants whose income is 40% or less of the area median gross income (or, when applicable, national nonmetropolitan median gross income or national non-metropolitan median income).
- You disposed of the building or your entire interest therein during the tax year and did not follow the procedures (described earlier under *Recapture and building dispositions*) to prevent recapture. In addition to using an imputed basis of zero on line 3, you may have to recapture a portion of credits previously taken. File Form 8611 to figure and report the recaptured amount. This paragraph affects only those taxpayers who dispose of the building or their entire interest therein. Those acquiring the building (or any interest therein) are not affected and, if the minimum set-aside requirements are otherwise satisfied, they may take a credit for the fraction of the year the building is owned by them.

Note. If the qualified basis of the building is zero, or if the building has an imputed qualified basis of zero, you may not claim a credit for the building for the tax year. You must enter zero on lines 3 and 16, and skip lines 4 through 15, 17, and 18.

At-risk limitation for individuals and closely held corporations. The basis of property may be limited if you borrowed against the property and are protected against loss, or if you borrowed money from a person who has other than a creditor interest in the property. See section 42(k).

Line 4. If you owned the building (or an interest therein) for the entire year, enter zero on line 4 and go to line 5.

Disposal of building or interest therein. If you disposed of a building or your entire interest therein during the tax year and you followed the procedures (described earlier under *Recapture and building dispositions*) to continue to claim the credit, you may claim a credit based only on the number of days during the tax year for which you owned the building or an interest therein.

Similarly, if you previously had no interest in the building, but you acquired the building or an interest therein during the tax year, you may claim a credit based only on the number of days during the tax year for which you owned the building or an interest therein.

The owner who has owned the building for the longest period during the month in which the change in ownership occurs is deemed to have owned the building for that month. If the seller and new owner have owned the building for the same amount of time during the month of disposition, the seller is deemed to have owned the building for that month.

Example. Both the buyer and the seller are calendar-year taxpayers. The sale takes place on May 25 of a 365-day calendar year. The qualified basis of the low-income building is $20,000. The seller and buyer will each complete a separate Form 8609-A, and enter $20,000 on line 3.

In this situation, the seller is deemed to have owned the building for all 31 days of May. Therefore, the seller owned the building for 151 days of the 365-day tax year, and the buyer owned the building for the remaining 214 days. The seller will multiply $20,000 by 151/365 to get $8,274. The seller will enter $8,274 on line 4 of his Form 8609-A. The buyer will multiply $20,000 by 214/365 to get $11,726. The buyer will enter $11,726 on line 4 of her Form 8609-A.

Pass-through entities. If the building is owned by a pass-through entity, the entity does not need to make any adjustment on line 4, unless the entity either disposes of the building or its entire interest therein, or acquires the building or an interest therein during the tax year (and the entity previously had no interest in the building). Do not make an adjustment on line 4 for changes in the interests of the members of the pass-through entity during the tax year. Instead, the entity must reflect these changes in the amount of credit it passes through to its members.

Line 5. If the agency has made an allocation on Form 8609, enter on line 5 the credit percentage shown on Form 8609, Part I, line 2. This percentage must be shown on line 5 as a decimal carried out to at least four places (for example, 8.13% would be shown on line 5 as .0813).

Buildings placed in service before July 31, 2008. If you were allocated a 70% present value credit percentage for a building that was not federally subsidized (as defined on the date the building was placed in service) and the building later

receives a federal subsidy, your credit percentage is reduced to the 30% present value credit that was in effect during the month the building was placed in service or for the month elected under former section 42(b)(2)(A)(ii), whichever applies. The 30% present value credit applies to the building for the year the federal subsidy was received and for the remainder of the compliance period, whether or not the federal subsidy is repaid. For the definition of federal subsidy that was in effect before July 31, 2008, see section 42(i)(2) (as in effect before July 31, 2008).

Buildings placed in service after July 30, 2008. If you were allocated a 70% present value credit percentage for a building that was not federally subsidized (as defined on the date the building was placed in service) and the building later receives a federal subsidy, your credit percentage is reduced to the 30% present value credit that was in effect during the month the building was placed in service or for the month elected under section 42(b)(1)[(A)](ii), whichever applies. The 30% present value credit applies to the building for the year the federal subsidy was received and for the remainder of the compliance period, whether or not the federal subsidy is repaid. For the definition of federal subsidy that was in effect after July 30, 2008, see section 42(i)(2) (as in effect after July 30, 2008).

Line 6. If you owned the building, or had an interest therein, for the entire tax year, multiply line 3 by line 5. If you had no ownership interest in the building for a portion of the tax year, multiply line 4 by line 5.

Lines 7 Through 12

If you are not claiming a credit for additions to qualified basis on line 7, skip lines 7 through 12 and go to line 13.

CAUTION *You may claim a credit for an addition to qualified basis only if the credit amounts have been allocated by the housing credit agency to cover these additions.*

Line 7. An addition to qualified basis results when there is an increase in the number of low-income units or an increase in the floor space of the low-income units over that which existed at the close of the first year of the credit period (before application of the modified percentage calculation). Credits for an addition to qualified basis are claimed at the reduced credit percentage of two-thirds of the credit percentage (expressed as a decimal carried out to at least four places) on line 5 through the end of the 15-year compliance period.

If you are claiming a credit for additions to qualified basis, you must subtract the original qualified basis of the building at the close of the first year of the credit period (see Form 8609, line 8a (Part II, line 2a, on the 1991 revision)) from the building's qualified basis entered on line 3. Enter the result on line 7. If the result is zero or less, skip lines 8 through 12 and enter the credit from line 6 on line 13.

Line 8. The determinations and calculations you make on line 8 follow the instructions for line 4. Therefore, if you owned the building (or an interest therein) for the entire year, enter zero on line 8 and go to line 9.

Disposal of building or interest therein. If you disposed of a building or your entire interest therein during the tax year, see *Disposal of building or interest therein* in the line 4 instructions; and, wherever line 3 and line 4 are referenced, substitute line 7 and line 8, respectively.

Pass-through entities. If the building is owned by a pass-through entity, see *Pass-through entities* in the line 4 instructions; and, wherever line 4 is referenced, substitute line 8 instead.

Line 9. The credit for additions to the building's qualified basis is determined using two-thirds of the credit percentage allowable for the building's original qualified basis. Therefore, one-third of the credit percentage (expressed as a decimal carried out to at least four places) on line 5 is not allowed. Enter on line 9 one-third of the amount shown on line 5. This amount must be reported on line 9 as a decimal carried out to at least four places (for example, if the credit percentage entered on line 5 is .0813, one-third of that percentage would be expressed as .0271). See section 42(f)(3).

Line 10. If you owned the building, or had an interest therein, for the entire tax year, multiply line 7 by line 9. If you had no ownership interest in the building for a portion of the tax year, multiply line 8 by line 9.

Line 11. Additions to qualified basis must be adjusted to reflect the average portion of the year that the low-income units relating to the increase were occupied. This adjustment is required if the increase in qualified basis of the building exceeds the qualified basis (including additions to qualified basis) of the building in any prior taxable year. To determine this adjustment amount, complete the worksheet on page 4.

Line 14. The eligible basis on line 1 must be reduced by federal grants received. If a reduction does not apply because this is the first year of the credit period (line 1 already reflects the reduction or noninclusion of a federal grant), or no federal grant was received, enter zero on line 14. Otherwise, follow the instructions that apply for the date the building was placed in service.

Buildings placed in service before July 31, 2008. Reduce the eligible basis on line 1 by the amount of any federal grant for the building, or the operation thereof, received during the 15-year compliance period.

Buildings placed in service after July 30, 2008. Reduce the eligible basis on line 1 by the amount of any costs financed by the proceeds of a federal grant.

Regardless of the date the building was placed in service, figure the reduction as follows.

Step 1. Divide the total amount of all federal grants received for the building during the compliance period that did not already reduce the amount of the eligible basis (reported on line 1) by the eligible basis on line 1 of this Form 8609-A. Enter the result as a decimal carried out to at least four places.

Note. If the eligible basis on line 1 of this Form 8609-A was increased by a percentage allowable under section 42(d)(5)(B) (former section 42(d)(5)(C) for buildings placed in service before July 31, 2008), and the increased percentage is reflected on line 3b of Form 8609, then increase the total amount of all federal grants in Step 1 by this percentage increase and divide this amount by the eligible basis on line 1 of this Form 8609-A. For example, if the percentage increase is 130% and all federal grants total $11,000, multiply $11,000 by 1.3000 and divide the result ($14,300) by the eligible basis on line 1.

Step 2. Multiply the decimal amount determined in Step 1 by the credit on line 13. Enter this result on line 14.

Line 16. To determine the amount to enter on line 16, see the information that follows in *1, 2, 3,* and *Special rules*.

1. If the building is owned completely by one taxpayer, enter the line 15 credit (after adjustment for any applicable special rule below) on line 16.

2. If the building is owned by more than one taxpayer, and those taxpayers are not members of a pass-through entity, then the line 15 credit (after adjustment for any applicable special rule below) must be distributed according to each taxpayer's respective ownership interest in the building. For example, if a building is owned by individuals A and B (60% by A and 40% by B), each would complete a separate Part II as follows. Lines 1 through 15 would be the same for each, assuming no part-year adjustments are necessary. However, A would enter 60% of line 15 on line 16, and B would enter 40% of line 15 on line 16. Therefore, enter on line 16 your share of the line 15 credit for the building that relates to your interest in the building. If your interest increases or decreases during the tax year, the change must be taken into account in determining your share of the line 15 credit.

Note. The aggregate credit claimed by the owners of the building cannot exceed the line 15 credit amount for the building.

3. If a pass-through entity is completing Form 8609-A as the sole owner of the building, enter the line 15 credit (after adjustment for any applicable special rule below) on line 16.

Special rules. If a taxpayer is subject to recapture upon the disposition of a building or interest therein because the taxpayer did not follow the procedures (described earlier under *Recapture and building dispositions*) to prevent recapture, no credit is allowed to the taxpayer for that percentage of the interest disposed of by the taxpayer. (However, see *De minimis recapture rule*, later.) The credit allowed to the taxpayer for the tax year is determined by reference to the taxpayer's remaining interest in the building at the close of the tax year. For example, assume that a taxpayer owns 100% of a building for 273 days in a 365-day calendar tax year, and 40% of the building for the remaining 92 days in the tax year (the taxpayer disposed of a 60% interest on the last day of September). If the taxpayer does not follow the procedures to prevent recapture, the taxpayer's credit on

line 16 would be based on 40% of the line 15 credit for the building. Similarly, although a taxpayer might not be subject to recapture upon a disposition of a *de minimis* portion (explained later) of the taxpayer's interest in the building, no credit is allowed to the taxpayer for the percentage of the interest disposed of by the taxpayer. The credit allowed to the taxpayer for the tax year is determined by reference to the taxpayer's remaining interest in the building at the close of the tax year.

If the taxpayer follows the procedures to prevent recapture, the taxpayer is allowed credit for the year both with respect to the ownership interest disposed of by the taxpayer and the interest retained by the taxpayer. For example, again assume that a taxpayer owns 100% of a building for the first 273 days in a 365-day calendar tax year and 40% of the building for the last 92 days of the year. After following procedures, the taxpayer's credit on line 16 would be based upon 273/365 of 100% (or 74.79%) of the line 15 credit for the building plus 92/365 of 40% (or 10.08%) of the line 15 credit amount.

If a taxpayer follows the procedures to prevent recapture upon the disposition of the building or upon a disposition of the taxpayer's entire interest in the building, the taxpayer's line 16 credit amount is determined by multiplying the line 15 credit amount by the percentage interest in the building disposed of by the taxpayer. For example, if a building is owned by individuals A and B (60% by A and 40% by B) and on the last day of the fifth month of the tax year, C buys A's 60% interest in the building and A follows the procedures, then A would enter 60% of line 15 on line 16. (Lines 4 and 8 have already taken into account the 5 months of the tax year that A held an interest in the building.)

De minimis recapture rule. For administrative purposes, the Service has adopted a *de minimis* rule that applies to partners in partnerships (other than partnerships to which section 42(j)(5)(B) applies) owning interests in qualified low-income buildings. The rule allows a partner to elect to avoid or defer recapture resulting from a disposition of interest in a partnership without posting bond (in a situation where it was necessary to post bond to avoid or defer recapture) until the partner has disposed of more than 33⅓ % of the partner's greatest total interest in the qualified low-income building through the partnership. See Rev. Rul. 90-60, 1990-2 C.B. 3, for more information on the *de minimis* rule.

Upon application by the building owner, the IRS may waive any recapture of the low-income housing credit for any *de minimis* error in complying with the minimum set-aside requirements.

Line 17. The first-year credit may have been reduced based on the number of full months the building was in service. The deferred balance of the credit for the first year is allowed in the 11th year. Include it on line 17 as a **positive** amount.

For example, see the example under *First-year modified percentage*, earlier. If this is the 11th year, enter .8750 times the eligible basis of the building (line 1) times the credit percentage (line 5). The factor .8750 is 1.0000 minus .1250, the modified percentage figured for year one in the example.

Line 18. For buildings placed in service after December 31, 2007, the credit is no longer limited by the alternative minimum tax rules. The amount on line 18 will be reported on Form 8586 as follows.

Credit for buildings placed in service before January 1, 2008. Report this amount on line 3 of Form 8586.

Credit for buildings placed in service after December 31, 2007. Report this amount on line 10 of Form 8586.

Paperwork Reduction Act Notice. We ask for the information on these forms to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is:

Recordkeeping	7 hr., 38 min.
Learning about the law or the form	1 hr., 47 min.
Preparing and sending the form to the IRS	1 hr., 59 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service at the address listed in the instructions for the tax return with which this form is filed.

Line 11 Worksheet (Keep for Your Records)

1	Enter the qualified basis of the building from line 3 of this tax year's Form 8609-A	**1**	
2	Multiply the amount on line 1 of the previous year's Form 8609-A by the amount on line 2 of that Form 8609-A	**2**	
3	Increased qualified basis. Subtract line 2 above from line 1 above. But if line 2 above is more than zero but less than the original qualified basis of the building entered on Form 8609, line 8a (Part II, line 2a on the 1991 revision), then enter the amount from line 7 of this Form 8609-A instead **Note.** *If line 3 above is zero or less, do not complete the rest of this worksheet. Instead, enter -0- on line 11 of Form 8609-A and go to line 12.*	**3**	
4	Modified percentage. For each month during the tax year, figure the increase, if any, in the low-income portion of the building for that month over the low-income portion of the building at the close of the previous tax year (the amount on line 2 of the previous tax year's Form 8609-A). For example, if the previous tax year's low-income portion of .5000 remained at .5000 for the first 9 months of this tax year and then increased to .7500 for October, November, and December, then subtract .5000 from .7500 to get an increase of .2500 for each month. Add these amounts together, divide by 12, and enter the result. (This amount must be shown as a decimal carried out to at least four places (for example, .2500 + .2500 + .2500 = .7500, divided by 12 = .0625.))	**4**	
5	Increased qualified basis entitled to reduced credit. Multiply line 4 above by Form 8609-A, line 1	**5**	
6	Increased qualified basis not entitled to reduced credit. Subtract line 5 above from line 3 above	**6**	
7	Line 11 modification. Multiply line 6 above by two-thirds of the amount on line 5 of Form 8609-A. Enter the result here and on line 11 of Form 8609-A	**7**	

Section 11

Safe Harbor

Rev. Proc. 2003-82

SECTION 1. PURPOSE

This revenue procedure provides safe harbors under which the Internal Revenue Service will treat a residential unit in a building as a low-income unit under §42(i)(3)(A) of the Internal Revenue Code if the incomes of the individuals occupying the unit are at or below the applicable income limitation under §42(g)(1) or §142(d)(4)(B)(i) before the beginning of the first taxable year of the building's credit period under §42(f)(1), but their incomes exceed the applicable income limitation at the beginning of the first taxable year of the building's credit period.

SECTION 2. BACKGROUND

.01 Questions have arisen regarding when individuals must satisfy the applicable income limitation under §42(g)(1) or §142(d)(4)(B)(i) when they move into a residential unit in an existing building under §42(i)(5) on or after the date a taxpayer acquires the existing building for rehabilitation under §42(e), but before the beginning of the first taxable year of the building's credit period under §42(f)(1). Because of these questions, some taxpayers require that the individuals' incomes not exceed the applicable income limitation at the beginning of the first taxable year of the building's credit period, even though the individuals' income did not exceed the applicable income limitation when the individuals moved into the unit. This has resulted in some individuals being evicted, where permissible under local law, from low-income housing projects.

.02 Section 42(a) provides that, for purposes of §38, the amount of the low-income housing credit determined for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

.03 Section 42(c)(2)(A) generally defines a qualified low-income building as any building which is part of a qualified low-income housing project at all times during the building's compliance period (which is defined in §42(i)(1) as the period of 15 taxable years beginning with the first taxable year of the credit period under §42(f)(1)).

.04 Section 42(i)(4) defines a new building as a building the original use of which begins with the taxpayer. An existing building is defined in §42(i)(5) as any building which is not a new building. Section 42(e)(1) provides that rehabilitation expenditures paid or incurred by the taxpayer with respect to any building are treated as a separate new building for purposes of §42.

.05 Section 42(f)(1) defines the credit period as the period of 10 taxable years beginning with (A) the taxable year in which the building is placed in service, or (B) at the election of the taxpayer, the succeeding taxable year, but in each case only if the building is a qualified low-income building as of the close of the first year of the period. Under §42(f)(5)(A), the credit period for an existing building must not begin before the first taxable year of the credit period for rehabilitation expenditures with respect to the building.

.06 Section 42(g)(1) defines a qualified low-income housing project as any project for residential rental use that meets one of the following requirements: (A) 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of the area median gross income, or (B) 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of the area median gross income. Under §42(g)(2), a residential unit is rent-restricted for purposes of §42(g)(1) if the gross rent for the unit does not exceed 30 percent of the imputed income limitation for the unit. Residential units that satisfy these rent and income requirements are defined in §42(i)(3)(A) as "low-income units." Section 42(i)(3)(B), (C), (D), and (E) provide more requirements for low-income units. Under §42(g)(4), a deep rent skewed project, as defined in §142(d)(4)(B), is also a qualified low-income housing project. To be a deep rent skewed project, §142(d)(4)(B)(i) requires that 15 percent or more of the low-income units in the project must be occupied by individuals whose income is 40 percent or less of the area median gross income.

.07 Section 42(g)(2)(D)(i) provides that, notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under §42(g)(1), the unit will continue to be treated as a low-income unit if the income of the occupants initially met the income limitation and the unit continues to be rent-restricted. However, under the available unit rule in §42(g)(2)(D)(ii), if the income of the occupants of the unit increases above 140 percent of the income limitation applicable under §42(g)(1), §42(g)(2)(D)(i) ceases to apply to the unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds the applicable income limitation. In the case of a deep rent skewed project described in §142(d)(4)(B), if the income of the occupants of the unit increases above 170 percent of the income limitation applicable under §42(g)(1), §42(g)(2)(D)(i) ceases to apply to the unit if any low-income unit in the building is occupied by a new resident whose income exceeds 40 percent of area median gross income. See also §1.42-15 of the Income Tax Regulations.

.08 Under §42(h)(1), the amount of the credit determined under §42(a) for any taxable year with respect to any building must not exceed the housing credit dollar amount allocated to the building. However, under §42(h)(4)(A), a credit allocation generally is not necessary for the portion of a building's eligible basis financed by an obligation the interest on which is exempt from tax under §103 and the obligation is taken into account under §146. Under §42(h)(4)(B), no credit allocation under §42(h)(1) is necessary for any portion of a building's eligible basis if 50 percent or more of the aggregate basis of the building and the land on which it is located is financed with tax-exempt obligations.

SECTION 3. SCOPE

This revenue procedure only applies to residential units in a building where the incomes of the individuals occupying the unit are at or below the applicable income limitation under §42(g)(1) or §142(d)(4)(B)(i) before the beginning of the first taxable year of the building's credit period under §42(f)(1), but their incomes exceed the applicable income limitation at the beginning of the first taxable year of the building's credit period.

SECTION 4. SAFE HARBORS

.01 Existing buildings under §42(i)(5) and new buildings under §42(e)(1). A residential unit in an existing building under §42(i)(5) or a new building under §42(e)(1) will be considered a low-income unit under §42(i)(3)(A) at the beginning of the first taxable year of the building's credit period under §42(f)(1) if:

(1) The individuals occupying the unit have incomes that are at or below the applicable income limitation under §42(g)(1) or §142(d)(4)(B)(i) on either the date the existing building was acquired by the taxpayer or the date the individuals started occupying the unit, whichever is later (based on the area median gross income on that date), but their incomes exceed the applicable income limitation at the beginning of the first taxable year of the building's credit period (based on the area median gross income on that date);

(2) The incomes of the individuals occupying the unit are first tested for purposes of the available unit rule under §42(g)(2)(D)(ii) and §1.42-15 at the beginning of the first taxable year of the building's credit period;

(3) The unit has been rent-restricted under §42(g)(2) from either the date the existing building was acquired by the taxpayer or the date the individuals started occupying the unit, whichever is later, to the beginning of the first taxable year of the building's credit period;

(4) Either:

(a) Section 42(h)(1) applies to the building and the taxpayer either receives an allocation to rehabilitate the existing building or enters into a binding commitment for an allocation to rehabilitate the existing building by either the end of the taxable year the taxpayer acquired the existing building or the end of the taxable year the individuals started occupying the unit, whichever is later; or

(b) Section 42(h)(1) does not apply to the building by reason of §42(h)(4) and the tax-exempt bonds for the project are issued by either the end of the taxable year the taxpayer acquired the existing building or the end of the taxable year the individuals started occupying the unit, whichever is later; and

(5) The unit has been a low-income unit under §42(i)(3)(B), (C), (D), and (E) from either the date the existing building was acquired by the taxpayer or the date the individuals started occupying the unit, whichever is later, to the beginning of the first taxable year of the building's credit period.

.02 New buildings under §42(i)(4) (not including new buildings under §42(e)(1)). A residential unit in a new building under §42(i)(4) will be considered a low-income unit under §42(i)(3)(A) at the beginning of the first taxable year of the building's credit period under §42(f)(1) if:

(1) The individuals occupying the unit have incomes that are at or below the applicable income limitation under §42(g)(1) or §142(d)(4)(B)(i) on the date the individuals started occupying the unit (based on the area median gross income on that date), but their incomes exceed the applicable income limitation in effect at the beginning of the first taxable year of the building's credit period (based on the area median gross income on that date);

(2) The incomes of the individuals occupying the unit are first tested for purposes of the available unit rule under §42(g)(2)(D)(ii) and §1.42-15 at the beginning of the first taxable year of the building's credit period;

(3) The unit has been rent-restricted under §42(g)(2) from the date the individuals started occupying the unit to the beginning of the first taxable year of the building's credit period;

(4) The taxpayer elects under §42(f)(1)(B) to treat the taxable year succeeding the taxable year the building was placed in service as the first taxable year of the credit period; and

(5) The unit has been a low-income unit under §42(i)(3)(B), (C), (D), and (E) from the date the individuals started occupying the unit to the beginning of the first taxable year of the building's credit period.

SECTION 5. AUDIT PROTECTION

If the taxpayer currently uses a method consistent with the safe harbors for determining whether a unit is a low-income unit under §42(i)(3)(A) at the beginning of the first taxable year of the building's credit period under §42(f)(1) (as described in section 4 of this revenue procedure), the issue will not be raised by the Service in a taxable year that ends before November 24, 2003. Also, if the taxpayer currently uses a method consistent with the safe harbors for determining whether a unit is a low-income unit under §42(i)(3)(A) at the beginning of the first taxable year of the building's credit period under §42(f)(1) (as described in section 4 of this revenue procedure) and the issue is under consideration (within the meaning of section 3.09 of Rev. Proc. 2002-9, 2002-1 C.B. 327) for taxable years in examination, before an appeals office, or before the U.S. Tax Court in a taxable year that ends before November 24, 2003, the issue will not be further pursued by the Service.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after November 24, 2003.

SECTION 7. DRAFTING INFORMATION

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

Section 12

Minimum Set-Aside Requirements

REVENUE RULE 90-89

1990-2 C.B. 8, 1990-44 I.R.B. 6.

Internal Revenue Service
Revenue Ruling

LOW-INCOME HOUSING CREDIT; MINIMUM SET-ASIDE REQUIREMENTS

Published: October 29, 1990

(See Also Section 142.)

Low-income housing credit; minimum set-aside requirements. For purposes of determining whether a building meets the minimum set-aside requirements of section 42(g)(1) of the Code, the combined income of all occupants of an apartment, whether or not legally related, is compared to the appropriate percentage of the median family income for a family with the same number of members.

ISSUE

For purposes of determining whether a building meets the minimum set-aside requirements of section 42(g)(1) of the Internal Revenue Code, how is the appropriate percentage of the area median gross income determined for occupants of an apartment when those occupants are not legally related?

FACTS

The owner of a newly constructed building wants to qualify the building for the low-income housing credit under section 42(a) of the Code. The owner has elected to qualify under the 40-60 minimum set-aside requirement of section 42(g)(1)(B), under which 40 percent or more of the building's aggregate residential rental units must be occupied by individuals with incomes of 60 percent or less of the area median gross income.

A and B are unrelated individuals who want to rent a two-bedroom apartment in the building. A and B each has income that does not exceed 60 percent of the area median gross income for one individual. However, A and B's combined income exceeds 60 percent of the area median gross income for a two-individual family.

LAW AND ANALYSIS

Section 38(a) of the Code provides for a general business credit against tax that includes the amount of the current year business credit. Section 38(b)(5) provides that the amount of the current year business credit includes the low- income housing credit determined under section 42(a).

Section 42(a) of the Code provides that, for purposes of section 38, the amount of the low-income housing credit determined under section 42 for any tax year in the credit period shall be an amount equal to the 'applicable percentage' of the qualified basis of each qualified low-income building.

Section 42(c)(2) of the Code defines the term 'qualified low-income building' as any building: (A) that is part of a qualified low-income housing project at all times during the period (i) beginning on the first day in the compliance period on which the building is part of such a project, and (ii) ending on the last day of the compliance period with respect to the building, and (B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.

Section 42(g)(1) of the Code defines the term 'qualified low-income housing project' as any project for residential rental property if the project meets the requirements of subparagraphs (A) and (B), whichever the taxpayers elects. The election is irrevocable. The project meets the requirements of section 42(g)(1)(A) if 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income. The project meets the requirements of section 42(g)(1)(B) if 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income. This rule is known as the 'minimum set-aside' requirement. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-92 (1986), 1986-3 (Vol. 4) C.B. 92.

Section 42(g)(4) of the Code provides, in part, that section 142(d)(2)(B) applies for purposes of determining whether any project is a low- income housing project and whether any unit is a low-income unit. Section 142(d)(2)(B) states that the income of individuals and area median gross income shall be determined in a manner consistent with determinations of lower income families and area median gross income under section 8 of the United States Housing Act of 1937 (or, if the program is terminated, under the program as in effect immediately before such termination). Determinations of area median gross income under the preceding sentence are adjusted for family size. The determination of an individual's or family's income for purposes of section 8 of the Housing Act of 1937 may differ materially from that individual's or family's income for federal income tax purposes.

In order to satisfy the minimum set-aside requirements of section 42(g)(1) of the Code, a specified percentage of apartments in a low-income housing project must be occupied by low-income tenants who meet the income limits of section 42(g)(1). Under sections 42(g)(1) and 142(d)(2)(B), tenants are considered low- income by reference to the area median gross income as adjusted for family size. These sections require that the income of all individuals in a family that share an apartment be aggregated and compared to the area median gross income for a family of the same size to determine if the minimum set-aside requirement is satisfied. Similarly, the income of all unrelated individuals who share an apartment should be aggregated and compared to the area median gross income for a family of the same size to determine if the minimum set- aside requirement is satisfied.

In this case, if A and B rent the apartment, that apartment does not count towards satisfying the minimum set-aside requirement of section 42(g)(1)(B) because A and B's combined income exceeds 60 percent of the area median gross income for a two-individual family.

HOLDING

For purposes of determining whether a building meets the minimum set-aside requirements of section 42(g)(1) of the Code, the combined income of all occupants of an apartment, whether or not legally related, is compared to the appropriate percentage of the median family income for a family with the number of members.

DRAFTING INFORMATION

The principal author of this revenue ruling is Paul F. Handleman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Handleman on (202) 377-6349 (not a toll-free call).

Rev. Rul. 90-89, 1990-2 C.B. 8, 1990-44 I.R.B. 6.

Section 13

Treatment of Resident Manager’s Unit

REVENUE RULE 92-61

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

Internal Revenue Service
Revenue Ruling

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

Published: August 10, 1992

Section 42. Low-Income Housing Credit

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

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

ISSUE

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

FACTS

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

LAW AND ANALYSIS

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

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

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

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

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

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

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

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

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

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

HOLDING

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

EFFECTIVE DATE

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

DRAFTING INFORMATION

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

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

Section 14

Changes in Median Gross Income

REVENUE RULE 94-57

1994-2 C.B. 5, 1994-37 I.R.B. 4.

Internal Revenue Service
Revenue Ruling

LOW-INCOME HOUSING CREDIT; CHANGES IN AREA MEDIAN GROSS INCOME; TENANT QUALIFICATION; AVAILABLE UNIT RULE

Published August 24, 1994

Section 42. - Low-Income Housing Credit

(See Also § 142(d.)

Low-income housing credit; changes in area median gross income; tenant qualification; available unit rule. This ruling concludes that (1) the income limitation used to initially qualify tenants in a low-income unit fluctuates with changes in area median gross income, and (2) owners must use the curren area median gross income to determine when the available unit rule of section 42(g)(2)(ii) applies. Rev. Rul. 89-24 modified and superseded.

ISSUES

For the low-income housing credit under s 42 of the Internal Revenue Code:

(1) What is the effect of a change in area median gross income (AMGI) on the income limitation used to determine whether a tenant qualifies as a low-income tenant under s 42(g)(1)?

(2) What is the effect of a change in AMGI on the determination of whether any available residential unit must be rented to a new low-income tenant under s 42(g)(2)(D)(ii)?

FACTS

The Project, a single-building, qualified low-income housing project, received a housing credit dollar amount allocation from a housing credit agency (the Agency) in 1990. The Project was placed in service and began its credit period in 1991. When the Project owner first filed the Project's Form 8609, Low-Income Housing Credit Allocation Certification, the Project owner elected the 40-60 test of s 42(g)(1)(B).

In January 1992, the Tenant took initial occupancy of a rent-restricted residential unit in the Project. At the time the Tenant initially occupied the unit, 60 percent of AMGI, as adjusted for family size, in the area in which the Project is located, as defined in Rev. Rul. 89-24, 1989-1 C.B. 24, was $30x and the Tenant's annual income was $29x. Therefore, the unit that the Tenant occupied qualified as a low-income unit under 42(i)(3).

On May 5, 1993, AMGI, as determined in a manner consistent with section 8 of the United States Housing Act of 1937 (H.U.D. section 8), decreased so that 60 percent of AMGI, as adjusted for family size, in the area in which the Project is located was $25x.

On March 30, 1994, the Tenant's annual income was recertified under s1.42- 5(b)(1)(vi) of the Income Tax Regulations at $36x.

On April 1, 1994, another residential unit in the Project, which was not a low-income unit, became vacant. That unit is of comparable size to the unit occupied by the Tenant. As of April 1, 1994, 60 percent of AMGI remained $25x, as adjusted for family size. At all times, the unit occupied by the Tenant remained rent-restricted.

LAW

Section 42(g)(1) defines a "qualified low-income housing project" as any project for residential rental use that meets one of the following requirements: (A) 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of AMGI, as adjusted for family size, or (B) 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of AMGI, as adjusted for family size. These requirements are referred to as the minimum set-asides. Section 142(d)(1) contains similar requirements for exempt facility bonds the net proceeds of which are to be used to provide qualified residential rental projects.

Section 42(i)(3)(A) defines the term "low-income unit" as any unit in a building if: (i) the unit is rent-restricted (as defined in s 42(g)(2)), and (ii) the individuals occupying the unit meet the income limitation applicable under s 42(g)(1) to the project of which the building is a part (low-income tenants).

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

Section 42(g)(2)(D)(ii) provides, however, that if the income of the occupants of the unit increases above 140 percent of the income limitation applicable under s 42(g)(1), a unit ceases to qualify as a low- income unit if any residential unit in the building (of a size comparable to, or smaller than, the unit) is occupied by a new resident whose income exceeds the income limitation. Section 142(d)(3) contains similar requirements for exempt facility bonds the net proceeds of which are to be used to provide qualified residential rental projects.

Under s 42(g)(4), s 142(d)(2)(B) applies when determining whether any project is a qualified low-income housing project and whether any unit is a low-income unit. Section 142(d)(2)(B) provides that the income of individuals and AMGI is determined in a manner consistent with determinations of lower income families and AMGI under H.U.D. section 8. Accordingly, the

determinations of lower income families and AMGI under H.U.D. section 8 apply to s 42(g)(1) and, therefore, to s 42(g)(2) and s 42(i)(3).

ANALYSIS

Issue 1. For a unit to be a low-income unit, a low-income tenant must meet the applicable income limitation elected by a project owner under s 42(g)(1) at the time the tenant initially occupies a rent-restricted residential unit in the owner's project. If a tenant initially satisfied the applicable income limitation, the unit remains a low-income unit, except as provided in s 42(g)(2)(D)(ii), notwithstanding an increase in the tenant's income (assuming the unit continues to be rent-restricted). See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-93 (1986). Similarly, if AMGI decreases in a project's area, a low-income tenant who occupied a residential unit prior to the decrease in AMGI will continue to qualify as a low-income tenant if the tenant qualified as a low-income tenant at the time of the tenant's initial occupancy. Thus, a change in a tenant's income or a change in AMGI occurring subsequent to the tenant's initial occupancy does not cause that tenant to cease to be a low- income tenant as of initial occupancy.

On the other hand, a decrease in AMGI commensurately decreases the income limitation under s 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the decrease in AMGI. Likewise, an increase in AMGI commensurately increases the income limitation under s 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the increase in AMGI. Therefore, a tenant that initially occupies a residential unit after the effective date of a change in AMGI (whether AMGI increases or decreases for the area) must qualify based on the AMGI in effect at the time the tenant initially occupies the unit.

Under the facts presented, as of its initial occupancy, the Tenant is a low-income tenant because the Tenant's annual income at the time the Tenant initially occupied a residential unit in the Project, $29x, was less than the income limitation applicable to the Project, $30x, as adjusted for family size. The result would be the same under s 142(d)(1).

Issue 2. Notwithstanding the analysis of Issue 1, if the income of the occupants in a low-income unit increases above 140 percent of the income limitation under s 42(g)(1), that unit ceases to qualify as a low-income unit unless the project owner rents any available residential unit of comparable or smaller size to a new low-income tenant. A decrease in AMGI decreases the income limitation under s 42(g)(1). Accordingly, a decrease in AMGI decreases the income limitation used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant under s 42(g)(2)(D)(ii). Likewise, an increase in AMGI increases the income limitation under s 42(g)(2)(D)(ii) used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant.

On April 1, 1994, 140 percent of the applicable income limitation for the Project was $35x (1.4 times $25x), as adjusted for family size. Because the Tenant's annual income is $36x, for the Tenant's unit to continue to qualify as a low-income unit, the Project owner must rent the

residential unit that became vacant on April 1, 1994, to a tenant whose income does not exceed the applicable income limitation of $25x, as adjusted for family size. The result would be the same under s 142(d)(3).

HOLDINGS

(1) A decrease in AMGI commensurately decreases the income limitation under s 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the decrease in AMGI. Likewise, an increase in AMGI commensurately increases the income limitation under s 42(g)(1) used to determine whether a tenant initially qualifies as a low-income tenant if the tenant's initial occupancy occurs on or after the effective date of the increase in AMGI. This holding would also apply under s 142(d)(1).

(2) A decrease in AMGI decreases the income limitation used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant under s 42(g)(2)(D)(ii). Likewise, an increase in AMGI increases the income limitation used to calculate whether a project owner must rent any available residential unit of comparable or smaller size to a new low-income tenant under s 42(g)(2)(D)(ii). This holding would also apply under s 142(d)(3).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 89-24, 1989-1 C.B. 24, 25, provides that a list of income limits released by the Department of Housing and Urban Development (HUD) may be relied upon until 30 days after the Internal Revenue Service publishes an announcement or notice in the Internal Revenue Bulletin indicating that HUD has released updated income limits. Rev. Rul. 89-24 is modified and superseded. In the future, taxpayers may rely on a list of income limits released by HUD until 45 days after HUD releases a new list of income limits, or until HUD's effective date for this new list, whichever is later. However, under s 7805(b), taxpayers may rely on the income limits in effect prior to May 5, 1993, until 30 days after [FNa1] .

PROSPECTIVE APPLICATION

The Service will not retroactively apply the holdings in this revenue ruling to the extent the holdings in this revenue ruling adversely affect taxpayers.

DRAFTING INFORMATION

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

FNa1. Insert date this revenue ruling is published in the Internal Revenue Bulletin.

Rev. Rul. 94-57, 1994-2 C.B. 5, 1994-37 I.R.B. 4.

Section 15

Gross Rent Floor

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

August 24, 1994

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

1. PURPOSE

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

2. BACKGROUND

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

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

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

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

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

financial feasibility of the project and its viability as a qualified low- income housing project throughout the credit period. Section 42(m)(2)(B) provides that in making the determination under section 42(m)(2)(A), an Agency shall consider (i) the sources and uses of funds and the total financing planned for the project, (ii) any proceeds or receipts expected to be generated by reason of tax benefits, (iii) the percentage of housing credit dollar amounts used for project costs other than the cost of intermediaries, and (iv) the reasonableness of the developmental and operational costs of the project. The gross rent under section 42(g)(2)(A) that a low-income housing project may generate is a source of funds an Agency must consider in making the determination under section 42(m)(2)(A).

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

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

3. SCOPE

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

4. PROCEDURE

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

For a bond-financed building, the Service will treat the gross rent floor in section 42(g)(2)(A) as taking effect on the date an Agency initially issues a determination letter to the building. However, the Service will treat the gross rent floor as taking effect on a building's placed in service date if the building owner designates that date as the date on which the gross rent floor

will take effect for the building. An owner must make this designation to use the placed in service date and inform the Agency that issued the determination letter to the building no later than the date on which the building is placed in service.

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

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

5. EFFECTIVE DATE

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

Section 16

Waiver of Annual
Income Recertification

NOT AVAILABLE IN HAWAII

Part III

Administrative, Procedural, and Miscellaneous

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

Rev. Proc. 2004-38

SECTION 1. PURPOSE

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

SECTION 2. BACKGROUND

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

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

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

SECTION 3. SCOPE

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

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

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

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

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

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

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

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

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

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

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

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

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

SECTION 6. EFFECT ON OTHER DOCUMENTS

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

SECTION 7. EFFECTIVE DATE

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

DRAFTING INFORMATION

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

APPENDIX

2004 Version of Form 8877

Section 17

Documentation of Income from Assets

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

October 11, 1994

1. Purpose

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

2. Background

Section 1.42-5 provides the minimum requirements that an Agency's compliance monitoring procedure must contain to satisfy its compliance monitoring duties under section 42(m)(1)(B)(iii). Section 1.42-5(b)(1)(vi) provides that an Agency must require an owner to keep records for each qualified low-income building in the project that show for each year in the compliance period the annual income certifications of each low-income tenant per unit. Section 1.42- 5(b)(1)(vii) provides that an Agency must require an owner to keep documents for each qualified low-income building in its project for each year in the compliance period that support each low-income tenant's income certification. The term "low-income tenant" refers to the individuals occupying a rent-restricted unit in a qualified low- income housing project whose annual income satisfies the section 42(g)(1) income limitation elected by the owner of the project. Examples of the documentation required under section 1.42- 5(b)(1)(vii) include a copy of the tenant's federal income tax return, Forms W-2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation. A verification of income from a third party is referred to as a "third party verification."

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

3. Scope

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

4. Procedure

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

.02 Except as provided in sections 4.03 and 4.04 of this revenue procedure, an Agency's

monitoring procedure may provide that an owner may satisfy the documentation requirement for income from assets in section 1.42-5(b)(1)(vii) for a low-income tenant whose Net Family assets do not exceed $5,000 by annually obtaining a signed, sworn statement that includes the following:

(1) That the tenant's Net Family assets do not exceed $5,000, and

(2) The tenant's annual income from Net Family assets.

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

.04 An Agency's monitoring procedure may continue to require that an owner obtain documentation, other than the statement described in section 4.02 of this revenue procedure, to support a low-income tenant's annual certification of income from assets.

5. Effective Date

This revenue procedure is effective October 11, 1994.

Section 18

Income Determination

Notice 88-80
1988-30 I.R.B. 28

NOTICE 88-80

LOW-INCOME HOUSING TAX CREDIT -- DETERMINATION OF INCOME FOR PURPOSES

OF SECTION 42(g)(1)

July 25, 1988

The purpose of this Notice is to inform taxpayers that regulations to be issued under section 42(g)(1) of the Internal Revenue Code of 1986 (the 'Code ') (relating to the determination of a qualified low-income housing project) will provide that the income of individuals and area median gross income (adjusted for family size) are to be made in a manner consistent with the determination of annual income and the estimates for median family income under section 8 of the United States Housing Act of 1937 (H.U.D. section 8).

For purposes of H.U.D. section 8, annual income is defined under 24 CFR 813.106 (1987). HUD section 8 median family income estimates (i.e., area median gross income estimates) are based on decennial Census data updated with bureau of the Census P-60 income data and Department of Commerce County Business Patterns employment and earnings data. The determination of annual income and median family income estimates are based on definitions of income that include some items of income that are not included in a taxpayer's gross income for purposes of computing Federal Income Tax liability. Thus, the income of individuals and area median gross income (adjusted for family size) for purposes of section 42(g)(1) of the Code will NOT be made by reference to items of income used in determining gross income for purposes of computing Federal Income Tax liability.

This document serves as an 'administrative pronouncement' as that term is described in section 1.661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

The principal author of this Notice is Christopher J. Wilson of the Legislation and Regulations Division. For further information regarding this Notice contact Mr. Wilson on (202) 566-4336 (not a toll-free call).

Internal Revenue Service
Notice 88-80

Section 19

Placement in Service

Internal Revenue Service's Advance Notice 88-116 On the Low-Income Housing Tax Credit, Issued Oct. 12, 1988

(Placement In Service)

Section 42(n)(1) of the Internal Revenue Code (the "Code") provides, generally, that the State housing credit ceiling under section 42(h) shall be zero for any calendar year after 1989. Thus, in general, all buildings eligible for the low-income housing credit must be placed in service before January 1, 1990. Under section 42(n)(2), however, 1989 credit amounts that are not allocated in 1989 may be applied to a building placed in service in 1990 if such building is constructed, reconstructed, or rehabilitated by the taxpayer and more than 10 percent of the reasonably anticipated cost of such construction, reconstruction, or rehabilitation has been incurred as of January 1, 1989. The purpose of this Notice is to provide guidance to taxpayers under section 42(n) of the Code regarding (1) what costs will be considered construction, reconstruction, or rehabilitation costs; and (2) when such costs will be considered to be incurred. In addition, this Notice provides guidance regarding when a building will be considered to be placed in service for purposes of section 42.

CONSTRUCTION, RECONSTRUCTION OR REHABILITATION COSTS

For purposes of section 42(n), the term construction, reconstruction, or rehabilitation costs means any amount that is (1) properly chargeable to a capital account and (2) incurred before or on January 1, 1989. Amounts are chargeable to a capital account if they are properly includible in computing eligible basis under section 42(d). Amounts treated as an expense and deducted in the year they are paid or incurred or amounts that are otherwise not added to eligible basis do not qualify. For example, the cost of acquisition of an existing building is a qualifying cost. Amounts incurred for taxes and architectural and engineering fees, site survey fees, legal expenses, insurance premiums, development fees, and other construction related costs satisfy the definition of construction, reconstruction, or rehabilitation costs if they are included in the eligible basis of the building. Production period interest (within the meaning of section 263A(f)) allocable to the construction, reconstruction, or rehabilitation of a building is a qualifying cost. The cost of land is not a qualifying cost. For purposes of section 42(n), the total anticipated costs of construction, reconstruction, or rehabilitation shall be determined by reference to a reasonable estimate, on or before January 1, 1989, of such amount.

COSTS INCURRED AS OF JANUARY 1, 1989

Construction, reconstruction, or rehabilitation costs are incurred for purposes of this section on the date such expenditures would be considered incurred under an accrual method of accounting, regardless of the method of accounting used by the taxpayer incurring the costs with respect to other items of income and expense.

PLACED IN SERVICE

For purposes of section 42, the term "placed in service" has two definitions--one for buildings and one for rehabilitation expenditures that are treated as a separate new building (section 42(e)(4)(A)). The placed-in-service date for a new or existing building used as residential rental property is the date on which the building is ready and available for its specifically assigned function, i.e., the date on which the first unit in the building is certified as being suitable for occupancy in accordance with state or local law. In general, a transfer of the building results in a new placed-in-service date if, on the date of the transfer, the building is occupied or ready for occupancy.

Under section 42(e)(4)(A) of the Code, rehabilitation expenditures that are treated as a separate new building are placed in service at the close of any 24-month period, over which such expenditures are aggregated. The placed-in-service date of section 42(e)(4)(A) applies even if the building is occupied during the rehabilitation period.

A building may be placed in service even if the rental units in the building are not currently occupied by low-income tenants.

This document serves as an "administrative pronouncement" as that term is described in 1.661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Section 20

Other IRS Forms

Form **8586**
(Rev. December 2016)
Department of the Treasury
Internal Revenue Service (99)

Low-Income Housing Credit

▶ **Attach to your tax return.**
▶ **Information about Form 8586 and its instructions is at *www.irs.gov/form8586*.**

OMB No. 1545-0984

Attachment Sequence No. **36a**

Name(s) shown on return

Identifying number

Part I Buildings Placed in Service Before 2008

1	Number of Forms 8609-A attached for buildings placed in service before 2008 . . . . . ▶ _____			
2	Has there been a decrease in the qualified basis of any buildings accounted for on line 1 since the close of the preceding tax year? ☐ **Yes** ☐ **No** If "Yes," enter the building identification numbers (BINs) of the buildings that had a decreased basis. If you need more space, attach a schedule. **(i)** _____ **(ii)** _____ **(iii)** _____ **(iv)** _____			
3	Current year credit from attached Form(s) 8609-A for buildings placed in service before 2008 (see instructions)	3		
4	Low-income housing credit for buildings placed in service before 2008 from partnerships, S corporations, estates, and trusts	4		
5	Add lines 3 and 4. Estates and trusts, go to line 6. Partnerships and S corporations, stop here and report this amount on Schedule K. All others, stop here and report this amount on Form 3800, Part III, line 1d, column (c)	5		
6	Amount allocated to beneficiaries of the estate or trust (see instructions)	6		
7	Estates and trusts, subtract line 6 from line 5. Report this amount on Form 3800, Part III, line 1d, column (c)	7		

Part II Buildings Placed in Service After 2007

8	Number of Forms 8609-A attached for buildings placed in service after 2007 . . . . . ▶ _____			
9	Has there been a decrease in the qualified basis of any buildings accounted for on line 8 since the close of the preceding tax year? ☐ **Yes** ☐ **No** If "Yes," enter the building identification numbers (BINs) of the buildings that had a decreased basis. If you need more space, attach a schedule. **(i)** _____ **(ii)** _____ **(iii)** _____ **(iv)** _____			
10	Current year credit from attached Form(s) 8609-A for buildings placed in service after 2007 (see instructions)	10		
11	Low-income housing credit for buildings placed in service after 2007 from partnerships, S corporations, estates, and trusts.	11		
12	Add lines 10 and 11. Estates and trusts, go to line 13. Partnerships and S corporations, stop here and report this amount on Schedule K. All others, stop here and report this amount on Form 3800, Part III, line 4d, column (c)	12		
13	Amount allocated to beneficiaries of the estate or trust (see instructions)	13		
14	Estates and trusts, subtract line 13 from line 12. Report this amount on Form 3800, Part III, line 4d, column (c)	14		

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Future developments. For the latest information about developments related to Form 8586 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/form8586*.

Purpose of Form

Use Form 8586 to claim the low-income housing credit. This general business credit is allowed for each new qualified low-income building placed in service after 1986. Generally, it is taken over a 10-year credit period.

The portion of the low-income housing credit attributable to buildings placed in service after 2007 is not limited by tentative minimum tax.

Taxpayers, other than partnerships, S corporations, estates, or trusts, whose only source of this credit is from those pass-through entities, are not required to complete or file this form. Instead, they can report this credit directly on Form 3800.

Qualified Low-Income Housing Project

The credit cannot exceed the amount allocated to the building. See section 42(h)(1) for details.

The low-income housing credit can only be claimed for residential rental buildings in low-income housing projects that meet one of the minimum set-aside tests. For details, see the Instructions for Form 8609, Part II, line 10c.

Except for buildings financed with certain tax-exempt bonds, you may not take a low-income housing credit on a building if it has not received an allocation from the housing credit agency. No allocation is needed when 50% or more of the aggregate basis of the building and the land on which the building is located is financed with certain tax-exempt bonds. The owner still must get a Form 8609 from the appropriate housing credit agency (with the applicable items completed, including an assigned BIN). "Land on which the building is located" includes only land that is functionally related and subordinate to the qualified low-income building (see Regulations sections 1.103-8(a)(3) and 1.103-8(b)(4)(iii)).

Recapture of Credit

There is a 15-year compliance period during which the residential rental building must continue to meet certain requirements. If, as of the close of any tax year in this period, there is a reduction in the qualified basis of the building from the previous year, you may have to recapture a part of the credit you have taken. Similarly, you may have to recapture part of the credits taken in previous years upon certain dispositions of the building or interests therein, unless you follow the procedures to prevent recapture. See *Recapture and building dispositions* in the Instructions for Form 8609-A, Annual Statement for Low-Income Housing Credit, for details. If you must recapture credits, use Form 8611, Recapture of Low-Income Housing Credit. See section 42(j) for details.

Recordkeeping

Keep a copy of this Form 8586 together with all Forms 8609, Schedules A (Form 8609) (and successor Forms 8609-A), and Forms 8611 for 3 years after the 15-year compliance period ends.

Specific Instructions

Line 2. A decrease in qualified basis will result in recapture if the qualified basis at the close of the tax year is less than the qualified basis at the close of the first year of the credit period.

If the reduction in qualified basis at the close of the tax year also results in a violation of the minimum set-aside requirement, then no credit is allowable for the year.

Line 3. The credit for the year is figured on Form 8609-A for each building. Attach a copy of each Form 8609-A you completed for the tax year to Form 8586. Enter on line 3 the total credit from attached Form(s) 8609-A for buildings placed in service before 2008.

Line 6. Estates or trusts. Allocate the low-income housing credit on line 5 between the estate or trust and the beneficiaries in the same proportion as income was allocated and enter the beneficiaries' share on line 6.

If the estate or trust is subject to the passive activity rules, include on line 4 any low-income housing credits attributable to buildings placed in service before 2008 from passive activities disallowed for prior years and carried forward to this year. Complete Form 8582-CR, Passive Activity Credit Limitations, to determine the allowed credit that must be allocated between the estate or trust and the beneficiaries. For details, see the Instructions for Form 8582-CR.

Line 9. A decrease in qualified basis will result in recapture if the qualified basis at the close of the tax year is less than the qualified basis at the close of the first year of the credit period.

If the reduction in qualified basis at the close of the tax year also results in a violation of the minimum set-aside requirement, then no credit is allowable for the year.

Line 10. The credit for the year is figured on Form 8609-A for each building. Attach a copy of each Form 8609-A you completed for the tax year to Form 8586. Enter on line 10 the total credit for attached Form(s) 8609-A for buildings placed in service after 2007.

Line 13. Estates or trusts. Allocate the low-income housing credit on line 12 between the estate or trust and the beneficiaries in the same proportion as income was allocated and enter the beneficiaries' share on line 13.

If the estate or trust is subject to the passive activity rules, include on line 11 any low-income housing credits attributable to buildings placed in service after 2007 from passive activities disallowed for prior years and carried forward to this year. Complete Form 8582-CR, Passive Activity Credit Limitations, to determine the allowed credit that must be allocated between the estate or trust and the beneficiaries. For details, see the Instructions for Form 8582-CR.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown below.

Recordkeeping	5 hr., 44 min.
Learning about the law or the form	52 min.
Preparing and sending the form to the IRS	2 hr., 11 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Form **8611**
(Rev. December 2013)
Department of the Treasury
Internal Revenue Service

Recapture of Low-Income Housing Credit

▶ **Attach to your return.**

▶ **Information about Form 8611 and its instructions is at *www.irs.gov/form8611*.**

Note: ***Complete a separate Form 8611 for each building to which recapture applies.***

OMB No. 1545-1035

Attachment Sequence No. **90**

A Name(s) shown on return		**B Identifying number**
C Address of building (as shown on Form 8609)	**D** Building identification number (BIN)	**E** Date placed in service (from Form 8609)
F If building is financed in whole or part with tax-exempt bonds, see instructions and furnish: **(1)** Issuer's name		**(2)** Date of issue
(3) Name of issue		**(4)** CUSIP number

Note: *Skip lines 1–7 and go to line 8 if recapture is passed through from a flow-through entity (partnership, S corporation, estate, or trust). However, section 42(j)(5) partnerships must complete lines 1 through 7.*

1	Enter total credits reported on Form 8586 in prior years for this building	**1**	
2	Credits included on line 1 attributable to additions to qualified basis (see instructions)	**2**	
3	Credits subject to recapture. Subtract line 2 from line 1	**3**	
4	Credit recapture percentage (see instructions)	**4**	.
5	Accelerated portion of credit. Multiply line 3 by line 4	**5**	
6	Percentage decrease in qualified basis. Express as a decimal amount carried out to at least 3 places (see instructions)	**6**	.
7	Amount of accelerated portion recaptured (see instructions if prior recapture on building). Multiply line 5 by line 6. Section 42(j)(5) partnerships, go to line 16. All other flow-through entities (except electing large partnerships), enter the result here and enter each recipient's share in the appropriate box of Schedule K-1. Generally, flow-through entities other than electing large partnerships will stop here. (**Note:** *An estate or trust enters on line 8 only its share of recapture amount attributable to the credit amount reported on its Form 8586.)*	**7**	
8	Enter recapture amount from flow-through entity (see **Note** above)	**8**	
9	Enter the unused portion of the accelerated amount from line 7 (see instructions)	**9**	
10	Net recapture. Subtract line 9 from line 7 or line 8. If less than zero, enter -0-	**10**	
11	Enter interest on the line 10 recapture amount (see instructions)	**11**	
12	Total amount subject to recapture. Add lines 10 and 11	**12**	
13	Unused credits attributable to this building reduced by the accelerated portion included on line 9 (see instructions)	**13**	
14	**Recapture tax.** Subtract line 13 from line 12. If zero or less, enter -0-. Enter the result here and on the appropriate line of your tax return (see instructions). If more than one Form 8611 is filed, add the line 14 amounts from all forms and enter the total on the appropriate line of your return. Electing large partnerships, see instructions	**14**	
15	**Carryforward of the low-income housing credit attributable to this building.** Subtract line 12 from line 13. If zero or less, enter -0- (see instructions)	**15**	

Only Section 42(j)(5) partnerships need to complete lines 16 and 17.

16	Enter interest on the line 7 recapture amount (see instructions)	**16**	
17	Total recapture. Add lines 7 and 16 (see instructions)	**17**	

General Instructions

Section references are to the Internal Revenue Code.

Future Developments

For the latest information about developments related to Form 8611 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/form8611*.

Purpose of Form

Use this form if you must recapture part of the low-income housing credit you claimed in previous years because the qualified basis decreased from one year to the next or you disposed of a building, or your interest therein, and you did not follow the procedures that would have prevented recapture of the credit.

Decrease in qualified basis. The decrease may result from a change in the eligible basis or the applicable fraction. For example, a decrease in qualified basis may exist when units are not occupied by income-qualified tenants under section 42(i)(3)(A)(ii), units are not rent restricted under section 42(g)(2), units are not suitable for occupancy as described in section 42(i)(3)(B)(ii), or the project no longer meets the minimum set aside requirements of section 42(g)(1).

Building dispositions. Disposing of a building or an interest therein will generate a credit recapture, unless it is reasonably expected that the building will continue to be operated as a qualified low-income building for the remainder of the building's compliance period.

See section 42(j) for more information.

Note. If the decrease in qualified basis is because of a change in the amount for which you are financially at risk on the building, then you must first recalculate the amount of credit taken in prior years under section 42(k) before you calculate the recapture amount on this form.

To complete this form you will need copies of the following forms that you have filed:

- Form 8586, Low-Income Housing Credit (and Form 3800, General Business Credit, if applicable);
- Form 8609, Low-Income Housing Credit Allocation and Certification (or predecessor, Form 8609, Low-Income Housing Credit Allocation Certification);
- Form 8609-A, Annual Statement for Low-Income Housing Credit (or predecessor, Schedule A (Form 8609), Annual Statement); and
- Form 8611.

Note. Flow-through entities must give partners, shareholders, and beneficiaries the information that is reported in items C, D, E, and F of Form 8611.

Recapture does not apply if:

- You disposed of the building or an ownership interest in it and you satisfy the requirements for avoiding recapture as outlined earlier under *Building dispositions*;
- You disposed of not more than 33 1/3% in the aggregate of your ownership interest in a building you held through a partnership, or you disposed of an ownership interest in a building you held through a partnership to which section 42(j)(5) applies or through an electing large partnership;
- The decrease in qualified basis does not exceed the additions to qualified basis for which credits were allowable in years after the year the building was placed in service; or
- The qualified basis is reduced because of a casualty loss, provided the property is restored or replaced within a reasonable period.

Recordkeeping

In order to verify changes in qualified basis from year to year, keep a copy of all Forms 8586, 8609, 8609-A (or predecessor, Schedule A (Form 8609)), 8611, and 8693 for 3 years after the 15-year compliance period ends.

Specific Instructions

Note. If recapture is passed through from a flow-through entity (partnership, S corporation, estate, or trust), skip lines 1–7 and go to line 8. However, section 42(j)(5) partnerships must complete lines 1 through 7.

Item F. If the building is financed with tax-exempt bonds, furnish the following information: (1) name of the entity that issued the bond (not the name of the entity receiving the benefit of the financing); (2) date of issue, generally the first date there is a physical exchange of the bonds for the purchase price; (3) name of the issue, or if not named, other identification of the issue; and (4) CUSIP number of the bond with the latest maturity date. If the issue does not have a CUSIP number, enter "None."

Line 1. Enter the total credits claimed on the building for all prior years from all Forms 8586 (before reduction due to the tax liability limit) you have filed. Prior to the December 2006 revision of Form 8586, the credits (before reduction due to the tax liability limit) were reported in Part I. Do not include credits taken by a previous owner.

Line 2 Worksheet (*Line reference is to Form 8609-A (or predecessor, Schedule A (Form 8609)).)

a	Enter the amount from line 10*	**a**	
b	Multiply **a** by 2	**b**	
c	Enter the amount from line 11*	**c**	
d	Subtract **c** from **b**	**d**	
e	Enter decimal amount figured in step **1** of the instructions for line 14*. If line 14* does not apply to you, enter -0-	**e**	
f	Multiply **d** by **e**	**f**	
g	Subtract **f** from **d**	**g**	
h	Divide line 16* by line 15*. Enter the result here	**h**	
i	Multiply **g** by **h**. Enter this amount on line 2. (If more than one worksheet is completed, add the amounts on **i** from all worksheets and enter the total on line 2.)	**i**	

Line 2. Determine the amount to enter on this line by completing a separate Line 2 Worksheet for each prior year for which line 7 of Form 8609-A (or predecessor, Schedule A (Form 8609)) was completed.

Line 4. Enter the credit recapture percentage, expressed as a decimal carried to at least 3 places, from the table below:

IF the recapture event occurs in . . .	THEN enter on line 4 . . .
Years 2 through 11	.333
Year 12	.267
Year 13	.200
Year 14	.133
Year 15	.067

Line 6. Enter the percentage decrease in qualified basis during the current year.

For this purpose, figure qualified basis without regard to any additions to qualified basis after the first year of the credit period. Compare any decrease in qualified basis first to additions to qualified basis. Recapture applies only if the decrease in qualified basis exceeds additions to qualified basis after the first year of the credit period.

If you disposed of the building or an ownership interest in it and did not satisfy the requirements for avoiding recapture as outlined earlier under *Building dispositions*, you must recapture all of the accelerated portion shown on line 5. Enter 1.000 on line 6.

Note. If the decrease causes the qualified basis to fall below the minimum set-aside requirements of section 42(g)(1) (the 20-50 test or the 40-60 test), then 100% of the amount shown on line 5 must be recaptured. Enter 1.000 on line 6. If you elected the 40-60 test for this building and the decrease causes you to fall below 40%, you cannot switch to the 20-50 test to meet the set-aside requirements. You must recapture the entire amount shown on line 5.

Line 7. If there was a prior recapture of accelerated credits on the building, do not recapture that amount again as the result of the current reduction in qualified basis. The example below demonstrates how to incorporate into the current (Year 4) recapture the first year (Year 1) accelerated portion as a result of a prior year (Year 2) recapture event.

Line 9. Figure the unused portion of the accelerated amount on line 7 by:

Step 1. Totaling the credits attributable to the building that you could not use in prior years.*

Step 2. Reducing the result of step 1 by any unused credits attributable to additions to qualified basis.

Step 3. Multiplying the result of step 2 by the decimal amount on line 4.

Step 4. Multiplying the result of step 3 by the decimal amount on line 6.

Step 5. Enter the result of step 4 on line 9.

*Generally, this is the amount of credit reported on line 1 of this Form 8611 reduced by the total low-income housing credits allowed on Form 8586 or Form 3800 for each year.

Special rule for electing large partnerships. Enter zero on line 9. An electing large partnership (defined in section 775) is treated as having fully used all prior year credits.

Line 11. Figure the interest separately for each prior tax year for which a credit is being recaptured. Interest must be figured at the overpayment rate determined under section 6621(a)(1) and compounded on a daily basis from the due date (not including extensions) of the return for the prior year until the earlier of (a) the due date (not including extensions) of the return for the recapture year, or (b) the date the return for the recapture year is filed and any income tax due for that year has been fully paid.

Tables of interest factors to figure daily compound interest were published in Rev. Proc. 95-17, 1995-1 C.B. 556. The interest rate in effect through December 31, 2013, is shown in Rev. Rul. 2013-16, 2013-40 I.R.B. 275. For periods after December 31, 2013, use the overpayment rate under section 6621(a)(1) in the revenue rulings published quarterly in the Internal Revenue Bulletin.

Note. If the line 8 recapture amount is from a section 42(j)(5) partnership, the partnership will figure the interest and include it in the recapture amount reported to you. Enter "-0-" on line 11 and write "Section 42(j)(5)" to the left of the entry space for line 11.

Line 13. Subtract the amount on line 9 from the total of all prior year unused credits attributable to the building (Step 1 of the line 9 instruction above). Enter the result on line 13.

Line 14. For information on how to report the recapture tax on Form 1040, see the instructions for line 60 (other taxes) in the Instructions for Form 1040. Form 1120 filers report the recapture tax on Form 1120, Schedule J, line 9b.

Special rule for electing large partnerships. Subtract the credit shown on Form 8586 from the total of the line 14 amounts from all Forms 8611. Enter the result (but not less than zero) on Form 1065-B, Part I, line 26.

Note. You must also reduce the current year low-income housing credit, before entering it on Schedules K and K-1, by the amount of the reduction to the total of the recapture amounts.

Line 15. Carry forward the low-income housing credit attributable to this building to the next tax year. See the Instructions for Form 3800 for details on how to report the carryforward of unused credits.

Line 7— *Example.* $2,700 of accelerated portion of low-income housing credit spread over a 10-year period and not falling below the minimum set-asides for the building. Also, there was a 20% reduction in qualified basis in Year 2 and 30% in Year 4.

	Year 1	Year 2	Year 3	Year 4*
Low-income housing credit	$270	$216 ($270 × .8 (20% reduction in qualified basis))	$270	$189 ($270 × .7 (30% reduction in qualified basis))
Recapture of Year 1 low-income housing credit		$18 ($270 × .333 × .2 (20% reduction in qualified basis))		$9 ($27 ($270 × .333 × .3 (30% reduction in qualified basis) minus $18 Year 2 recapture))

* You will have to complete the rest of the form to figure the recapture as the result of the current year reduction in basis as it affects the Year 2 and Year 3 credit.

Lines 16 and 17. Only section 42(j)(5) partnerships complete these lines. This is a partnership (other than an electing large partnership) that has at least 35 partners, unless the partnership elects (or has previously elected) not to be treated as a section 42(j)(5) partnership. For purposes of this definition, an individual and his or her spouse (and their estates) are treated as one partner.

For purposes of determining the credit recapture amount, a section 42(j)(5) partnership is treated as the taxpayer to which the low-income housing credit was allowed and as if the amount of credit allowed was the entire amount allowable under section 42(a).

See the instructions for line 11 to figure the interest on line 16. The partnership must attach Form 8611 to its Form 1065 and allocate this amount to each partner on Schedule K-1 (Form 1065) in the same manner as the partnership's taxable income is allocated to each partner.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown below.

Recordkeeping . . . . 8 hr., 21 min.

Learning about the law or the form . . . . . 1 hr.

Preparing and sending the form to the IRS . . 1 hr., 10 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the IRS at the address listed in the instructions for the tax return with which this form is filed.

Form **8823**
(Rev. September 2015)
Department of the Treasury
Internal Revenue Service

Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition

Note: *File a separate Form 8823 for each building that is disposed of or goes out of compliance.*
▶ Information about Form 8823 is available at *www.irs.gov/form8823.*

OMB No. 1545-1204

Check here if this is an amended return ▶ ☐

IRS Use Only

1 Building name (if any). Check if item 1 differs from Form 8609 ▶ ☐

Street address

City or town, state, and ZIP code

2 Building identification number (BIN)

3 Owner's name. Check if item 3 differs from Form 8609 ▶ ☐

Street address

City or town, state, and ZIP code

4 **Owner's** taxpayer identification number ☐ EIN ☐ SSN

5 Total credit allocated to this BIN . . . . . ▶ $

6 If this building is part of a multiple building project, enter the number of buildings in the project . . . . . ▶

7a Total number of residential units in this building . . . . . ▶

b Total number of low-income units in this building . . . . . ▶

c Total number of residential units in this building determined to have noncompliance issues . . . . . ▶

d Total number of units reviewed by agency (see instructions) . . . . . ▶

8 Date building ceased to comply with the low-income housing credit provisions (see instructions) (MMDDYYYY) . .

9 Date noncompliance corrected (if applicable) (see instructions) (MMDDYYYY) . . . . . .

10 Check this box if you are filing only to show correction of a previously reported noncompliance problem . . . . . ▶ ☐

11 Check the box(es) that apply:	Out of compliance	Noncompliance corrected
a Household income above income limit upon initial occupancy	☐	☐
b Owner failed to correctly complete or document tenant's annual income recertification	☐	☐
c Violation(s) of the UPCS or local inspection standards (see instructions) (attach explanation)	☐	☐
d Owner failed to provide annual certifications or provided incomplete or inaccurate certifications	☐	☐
e Changes in Eligible Basis or the Applicable Percentage (see instructions)	☐	☐
f Project failed to meet minimum set-aside requirement (20/50, 40/60 test) (see instructions)	☐	☐
g Gross rent(s) exceed tax credit limits	☐	☐
h Project not available to the general public (see instructions) (attach explanation)	☐	☐
i Violation(s) of the Available Unit Rule under section 42(g)(2)(D)(ii)	☐	☐
j Violation(s) of the Vacant Unit Rule under Reg. 1.42-5(c)(1)(ix)	☐	☐
k Owner failed to execute and record extended-use agreement within time prescribed by section 42(h)(6)(J)	☐	☐
l Low-income units occupied by nonqualified full-time students	☐	☐
m Owner did not properly calculate utility allowance	☐	☐
n Owner has failed to respond to agency requests for monitoring reviews	☐	☐
o Low-income units used on a transient basis (attach explanation)	☐	☐
p Building is no longer in compliance nor participating in the section 42 program (attach explanation)	☐	
q Other noncompliance issues (attach explanation)	☐	☐

12 Additional information for any item above. Attach explanation and check box . . . . . ▶ ☐

13a Building disposition by ☐ Sale ☐ Foreclosure ☐ Destruction ☐ Other (attach explanation)

b Date of disposition (MMDDYYYY)

c New owner's name

d **New owner's** taxpayer identification number ☐ EIN ☐ SSN

Street address

14 Name of contact person

City or town, state, and ZIP code

15 Telephone number of contact person

Ext.

Under penalties of perjury, I declare that I have examined this report, including accompanying statements and schedules, and to the best of my knowledge and belief, it is true, correct, and complete.

▶ Signature of authorizing official ▶ Print name and title ▶ Date (MMDDYYYY)

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 12308D

Form **8823** (Rev. 9-2015)

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Future developments. For the latest information about developments related to Form 8823 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/form8823.*

Purpose of Form

Housing credit agencies use Form 8823 to fulfill their responsibility under section 42(m)(1)(B)(iii) to notify the IRS of noncompliance with the low-income housing tax credit provisions **or** any building disposition.

The housing credit agency should also give a copy of Form 8823 to the owner(s).

Who Must File

Any authorized housing credit agency that becomes aware that a low-income housing building was disposed of or is not in compliance with the provisions of section 42 must file Form 8823.

When To File

File Form 8823 no later than 45 days after **(a)** the building was disposed of or **(b)** the end of the time allowed the building owner to correct the condition(s) that caused noncompliance. For details, see Regulations section 1.42-5(e).

Where To File

File Form 8823 with the:

Department of the Treasury
Internal Revenue Service Center
Philadelphia, PA 19255-0549

Specific Instructions

Amended return. If you are filing an amended return to correct previously reported information, check the box at the top of page 1.

Item 2. Enter the building identification number (BIN) assigned to the building by the housing credit agency as shown on Form 8609.

Items 3, 4, 13c, and 13d. If there is more than one owner (other than as a member of a pass-through entity), attach a schedule listing the owners, their addresses, and their taxpayer identification numbers. Indicate whether each owner's taxpayer identification number is an employer identification number (EIN) or a social security number (SSN).

Both the EIN and the SSN have nine digits. An EIN has two digits, a hyphen, and seven digits. An SSN has three digits, a hyphen, two digits, a hyphen, and four digits, and is issued only to individuals.

Item 7d. "Reviewed by agency" includes physical inspection of the property, tenant file inspection, or review of documentation submitted by the owner.

Item 8. Enter the date that the building ceased to comply with the low-income housing credit provisions. If there are multiple noncompliance issues, enter the date for the earliest discovered issue. **Do not** complete item 8 for a building disposition. Instead, skip items 9 through 12, and complete item 13.

Item 9. Enter the date that the noncompliance issue was corrected. If there are multiple issues, enter the date the last correction was made.

Item 10. Do not check this box unless the sole reason for filing the form is to indicate that previously reported noncompliance problems have been corrected.

Items 11a to 11p. Check only the "out of compliance" box if the issue causing the noncompliance remains uncorrected at the end of the correction period. Check both the "out of compliance" and "noncompliance corrected" boxes if the noncompliance was corrected within the correction period. Check only the "noncompliance corrected" box if the noncompliance was previously reported to the IRS on a separate Form 8823.

Item 11c. Housing credit agencies must use either **(a)** the local health, safety, and building codes (or other habitability standards) or **(b)** the Uniform Physical Condition Standards (UPCS) (24 C.F.R. section 5.703) to inspect the project, but not in combination. The UPCS does not supersede or preempt local codes. Thus, if a housing credit agency using the UPCS becomes aware of any violation of local codes, the agency must report the violation. Attach a statement describing either **(a)** the deficiency and its severity under the UPCS, i.e., minor (level 1), major (level 2), and severe (level 3) or **(b)** the health, safety, or building violation under the local codes. The Department of Housing and Urban Development's Real Estate Assessment Center has developed a comprehensive description of the types and severities of deficiencies entitled "Revised Dictionary of Deficiency Definitions" found at *www.hud.gov*. Under Regulations section 1.42-5(e)(3), report all deficiencies to the IRS whether or not the noncompliance or failure to certify is corrected at the time of inspection.

Item 11d. Report the failure to provide annual certifications or the provision of certifications that are known to be incomplete or inaccurate as required by Regulations section 1.42-5(c). As examples, report a failure by the owner to include a statement summarizing violations (or copies of the violation reports) of local health, safety, or building codes; report an owner who provided inaccurate or incomplete statements concerning corrections of these violations.

Item 11e. For buildings placed in service before July 31, 2008, report any federal grant made with respect to any building or the operation thereof during any tax year in the compliance period. For buildings placed in service after July 30, 2008, report any federal grant used to finance any costs that were included in the eligible basis of any building. Report changes in common areas which become commercial, when fees are charged for facilities, etc. In addition, for buildings placed in service before July 31, 2008, report any below market federal loan or any obligation the interest on which is exempt from tax under section 103 that is or was used (directly or indirectly) with respect to the building or its operation during the compliance period and that was not taken into account when determining eligible basis at the close of the first

year of the credit period. For buildings placed in service after July 30, 2008, report any obligation the interest on which is exempt from tax under section 103 that is or was used (directly or indirectly) with respect to the building or its operation during the compliance period and that was not taken into account when determining eligible basis at the close of the first year of the credit period.

Item 11f. Failure to satisfy the minimum set-aside requirement for the first year of the credit period results in the permanent loss of the entire credit.

Failure to maintain the minimum set-aside requirement for any year after the first year of the credit period results in recapture of previously claimed credit and no allowable credit for that tax year. No low-income housing credit is allowable until the minimum set-aside is restored for a subsequent tax year.

Item 11h. All units in the building must be for use by the general public (as defined in Regulations section 1.42-9 and further clarified in section 42(g)(9)), including the requirement that no finding of discrimination under the Fair Housing Act occurred for the building. Low-income housing credit properties are subject to Title VIII of the Civil Rights Act of 1968, also known as the Fair Housing Act. The Act prohibits discrimination in the sale, rental, and financing of dwellings based on race, color, religion, sex, national origin, familial status, and disability. See 42 U.S.C.A. sections 3601 through 3619.

It also mandates specific design and construction requirements for multifamily housing built for first occupancy after March 13, 1991, in order to provide accessible housing for individuals with disabilities. The failure of low-income housing credit properties to comply with the requirements of the Fair Housing Act will result in the denial of the low-income housing tax credit on a per-unit basis.

Individuals with questions about the accessibility requirements can obtain the Fair Housing Act Design Manual through *www.huduser.org.*

Item 11i. The owner must rent to low-income tenants all comparable units that are available or that subsequently become available in the same building in order to continue treating the over-income unit(s) as a low-income unit. All units affected by a violation of the available unit rule may not be included in qualified basis. When the percentage of low-income units in a building again equals the percentage of low-income units on which the credit is based, the full availability of the credit is restored. Thus, only check the “Noncompliance corrected” box when the percentage of low-income units in the building equals the percentage on which the credit is based.

Item 11k. Section 42(h)(6) requires owners of tax credit properties to enter into an extended use agreement with the state agency that allocated the credits to the project. Building owners must agree to a long-term commitment beginning on the first day of the 15-year compliance period and ending on the later of (1) the date specified by the state agency in the agreement or (2) the date which is 15 years after the close of the 15-year compliance period.

The extended use agreement must (1) specify that the applicable fraction for the building for each year in the extended use period will not be less than the applicable fraction specified in the extended use agreement and prohibit the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or any increase in the gross rent with respect to such unit not otherwise permitted under section 42, (2) allow individuals (whether prospective, present, or former occupants) who meet the income limitations applicable to the building under section 42(g) the right to enforce in state court the requirements and prohibitions under section 42(h)(6)(B)(i) throughout the extended use period, (3) prohibit the disposition to any person of any portion of the building unless all of the building is disposed of to that person, (4) prohibit the refusal to lease to section 8 voucher holders because of the status of the prospective tenant as such a holder, and (5) provide that the agreement is binding on all successors of the taxpayer. The extended use agreement must be recorded as a restrictive covenant with respect to the property under state law.

Noncompliance should be reported if an extended use agreement is not executed and recorded as a restrictive covenant with respect to the property under state law or the owner failed to correct the noncompliance within the one-year correction period provided by section 42(h)(6)(J). The one-year correction period begins when the agency notifies the owner in writing that an extended use agreement is not recorded as a restrictive covenant with respect to the property under state law. A copy of the notification letter should be included as an attachment to Form 8823 when filed with the IRS.

Item 11q. Check this box for noncompliance events other than those listed in 11a through 11p. Attach an explanation. For projects with allocations from the nonprofit set-aside under section 42(h)(5), report the lack of material participation by a non-profit organization (i.e., regular, continuous, and substantial involvement) that the housing credit agency learns of during the compliance period.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping . . . . . 11 hr., 43 min.

Learning about the law or the form . . . . . 1 hr., 35 min.

Preparing and sending the form to the IRS . . . . . 1 hr., 51 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can send your comments to *www.irs.gov/formspubs.* Click on “More Information” and then on “Give us feedback.” Or you can send your comments to the Internal Revenue Service, Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224. **Do not** send the form to this address. Instead, see *Where To File,* earlier.

Section 21

Available Unit Rule

Federal Regulations

Reg § 1.42-15. Available unit rule.

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

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

(1) The unit continues to be treated as a low-income unit; and

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

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

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

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

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

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

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

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

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

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

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

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

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

Section 22

HUD 4350.3 REV-1 Appendix 3:
Acceptable forms of Verification

Appendix 3

Acceptable Forms of Verification

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Age. *(See Chapter 3, Paragraph 3-28.C)*	• None required.	• None required.	• None required.	• Birth Certificate • Baptismal Certificate • Military Discharge papers • Valid passport • Census document showing age • Naturalization certificate • Social Security Administration Benefits printout		

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Alimony or child support. *(See Chapter 5, Paragraphs 5-6.F and 5-10.F)*	• Copy of separation or divorce agreement provided by ex-spouse or court indicating type of support, amount, and payment schedule. • Written statement provided by ex-spouse or income source indicating all of above. • If applicable, written statement from court/attorney that payments are not being received and anticipated date of resumption of payments.	• Recent original letters from the court.	• Telephone or in-person contact with ex-spouse or income source documented in file by the owner.	• Copy of most recent check, recording date, amount, and check number.	• Notarized statement or affidavit signed by applicant indicating amount received. • If applicable, notarized statement or affidavit from applicant indicating that payments are not being received and describing efforts to collect amounts due.	• Amounts awarded but not received can be excluded from annual income only when applicants have made reasonable efforts to collect amounts due, including filing with courts or agencies responsible for enforcing payments.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Assets disposed of for less than fair market value. *(See Chapter 5, Paragraph 5-7.G.8)*	• None required.	• None required.	• None required.	• None required.	• Certification signed by applicant *and/or tenant* that no *family* member has disposed of assets for less than fair market value during *the* preceding two years. • If applicable, certification signed by the owner of the asset disposed of that shows: - Type of assets disposed of; - Date disposed of; - Amount received; and - Market value of asset at the time of disposition.	• Only count assets disposed of within a two-year period prior to *certification or recertification.*

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Auxiliary apparatus. *(See Chapter 5, Paragraph 5-10.C)*	• Written verification from source of costs and purpose of apparatus. • Written certification from doctor or rehabilitation agency that use of apparatus is necessary to employment of any family member. • In a case where the disabled person is employed, statement from employer that apparatus is necessary for employment.	• Copies of receipts.	• Telephone or in-person contact with these sources documented in file by the owner.	• Evidence of periodic payments for apparatus.	• Not appropriate.	• The owner must determine if the expense is to be considered a medical or disability assistance.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Care attendant for disabled family members. *(Paragraph 5-10.C)*	• Written verification from attendant stating amount received, frequency of payments, hours of care. • Written certification from doctor or rehabilitation agency that care is necessary to employment of family member.	• Copies of receipts.	• Telephone or in-person contact with source documented in file by the owner.	• Cancelled checks indicating payment amount and frequency.	• Notarized statement or signed affidavit attesting to amounts paid.	• The owner must determine if this expense is to be considered a medical or disability assistance.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Child care expenses (including verification that a family member who has been relieved of child care is working, attending school, or looking for employment). *(Paragraph 5-10.B)*	• Written verification from person who provides care indicating amount of payment, hours of care, names of children, frequency of payment, and whether or not care is necessary to employment or education. • Verification of employment as required under Employment Income. • Verification of student status (full or part-time) as required under Full-Time Student Status.	• Copies of receipts	• Telephone or in-person contact with these sources (child care provider, employer, school) documented in file by the owner.	• Cancelled checks indicating payments. • For school attendance, school records, such as paid fee statements that show that the time and duration of school attendance reasonably corresponds to the period of child care.	• For verification of "looking for work," details of job search effort as required by owner's written policy.	• Allowance provided only for care of children 12 and younger. • When same care provider takes care of children and disabled person, the owner must prorate expenses accordingly. • Owners should keep in mind that costs may be higher in summer months and during holiday periods. • The owner must determine which family member has been enabled to work. • Care for employment and education must be prorated to compare to earnings. • Costs must be "reasonable."

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Citizenship *(See Chapter 3, Paragraph 3-12)*					• Citizens must sign declaration certifying U.S. Citizenship.	• Owners may require applicants/residents to provide verification of citizenship.
• Current net family assets. *(See Chapter 5, Paragraph 5-7.C)*	• Verification forms, letters or documents received from financial institutions, stock brokers, real estate agents, employers indicating the current value of the assets and penalties or reasonable costs to be incurred in order to convert nonliquid assets into cash.	• Passbooks, checking, or savings account statements, certificates of deposit, property appraisals, stock or bond documents, or other financial statements completed by financial institution. • Copies of real estate tax statements, if tax authority uses approximate market value. • Copies of real estate closing documents that indicate distribution of sales proceeds and settlement costs.	• Telephone or in-person contact with appropriate source, documented in file by the owner.	• Quotes from attorneys, stockbrokers, bankers, and real estate agents that verify penalties and reasonable costs incurred to convert asset to cash.	• Notarized statement or signed affidavit stating cash value of assets or verifying cash held at applicant's home or in safe deposit box.	• Use current balance in savings accounts and average monthly balance in checking accounts for last 6 months. • Use cash value of all assets (the net amount the applicant would receive if the asset were converted to cash). • **NOTE:** This information can usually be obtained simultaneously when verifying income from assets and employment (e.g., value of pension).

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Disability status. *(Paragraph 3-28.B)*	• Verification from *appropriate source of information* stating that individual qualifies under the definition of disability.	• Not appropriate.	• Telephone or in-person contact with medical professional verifying qualification under the federal disability definition and documentation in the file of the conversation.	• Not appropriate.	• Not appropriate.	• If a person receives Social Security Disability solely due to a drug or alcohol problem, the person is not considered disabled under housing law. A person that does not receive Social Security Disability may still qualify under the definition of a person with disabilities. • Owners must not seek to verify information about a person's specific disability other than obtaining a professional's opinion of qualification under the definition of a person with disabilities.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Dividend income and savings account interest income. *(See Chapter 5, Paragraph 5-7)*	• Verification form completed by bank.	• Copies of current statements, bank passbooks, certificates of deposit, if they show required information (i.e., current rate of interest). • Copies of Form 1099 from the financial institution, and verification of projected income for the next 12 months. • Broker's quarterly statements showing value of stocks/bonds and earnings credited to the applicant.	• Telephone or in-person contact with appropriate party, documented in file by the owner.		• Notarized statement or signed affidavit stating dividend income and savings account interest income.	• The owner must obtain enough information to accurately project income over next 12 months. • Verify interest rate as well as asset value.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Employment Income including tips, gratuities, overtime. *(See Chapter 5, Paragraph 5-5.A and C and Paragraph 5-6.)*	• *EIV Income Report (mandatory)* • Verification form completed by employer. See Paragraph 9-10 for situations when this method of verification must be used prior to verifying through an original or authentic document generated by a third-party source.	• W-2 Forms, if applicant has had same employer for at least two years and increases can be accurately projected. • Paycheck stubs or earning statements.	• Telephone or in-person contact with employer, specifying amount to be paid per pay period and length of pay period. Document in file by the owner.		• Notarized statements or affidavits signed by applicant that describe amount and source of income.	• *It is mandatory that the EIV Income Report be used as third-party verification of employment and income (24 CFR 5.233).* • Always verify: frequency of gross pay (i.e., hourly, biweekly, monthly, bimonthly); anticipated increases in pay and effective dates; overtime. • Require most recent *4-6* consecutive pay stubs; do not use check without stub. • For a fee, additional information can be obtained from The Work Number 800-996-7556; First American Registry 800-999-0350; and Verifax 800-969-5100. Fees are valid project expenses. Information does not replace third-party verification.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Family composition. *(See Chapter 3, Paragraph 3-27)*	• None required.	• None required.	• None required.	• Birth certificates • Divorce actions • Drivers' licenses • Employer records • Income tax returns • Marriage certificates • School records • Social Security Administration records • Social service agency records • Support payment records • Utility bills • Veterans Administration (VA) records		• An owner may seek verification only if the owner has clear written policy.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Family type. (Information verified only to determine eligibility for project, preferences, and allowances.) *(See Chapter 3, Paragraph 3-28)*	• Disability Status: statement from physician or other reliable source, if benefits documenting status are not received. See paragraph 3.25 B.1 for restrictions on this form of verification. • Displacement Status: Written statement or certificate of displacement by the appropriate governmental authority.		• Telephone or in-person contact with source documented in file by the owner.	• Elderly Status (when there is reasonable doubt that applicant is at least 62): birth certificate, baptismal certificate, social security records, driver's license, census record, official record of birth or other authoritative document or receipt of SSI old age benefits or SS benefits. • Disabled, blind: evidence of receipt of SSI or Disability benefits.	• Elderly Status: Applicant's signature on application is generally sufficient.	• *When* the applicant receives income or benefits for which elderly or disabled status is a requirement, such status must be verified. • Status of disabled family members must be verified for entitlement to $480 dependent deduction and disability assistance allowance. • Owner may not ask the nature/extent of disability.
• Full-time student status (of family member 18 or older, excluding head, spouse, or foster children). *(See Chapter 5, Paragraph 5-6.A.3)*	• Verification from the Admissions or Registrar's Office or dean, counselor, advisor, etc., or from VA Office.		• Telephone or in-person contact with these sources documented in file by the owner.	• School records, such as paid fee statements that show a sufficient number of credits to be considered a full-time student by the educational institution attended.	• Not appropriate.	

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Immigration Status. *(See Chapter 3, Paragraph 3-12)*	• Verification of eligible immigration status must be received from DHS through the DHS SAVE system or through secondary verification using DHS Form G-845.		• None.	• Applicant/resident must provide appropriate immigration documents to initiate verification.	• Noncitizens must sign declaration certifying the following: Eligible immigration status; or Decision not to claim eligible status.	• Owners must require noncitizens requesting assistance to provide verification of eligible immigration status.
• *Immigration Status (SSN) Individuals who do not contend eligible immigration status under the Section 221(d)(3) BMIR, Section 202 PAC, Section 202 PRAC, Section 811 PRAC programs (See Chapter 3, Paragraph 3-9.A)*					• *Self-certification that they do not contend eligible immigration status.*	• *This verification is for exemption of the requirement to disclose and provide verification of a SSN when an individual does not contend eligible immigration status only for the programs listed in the Factor to be Verified column.*

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Income maintenance payments, benefits, income other than wages (i.e., welfare, Social Security [SS], Supplemental Security Income [SSI], Disability Income, Pensions). *(See Chapter 5, Paragraph 5-6)*	• * EIV Income Report for Social Security benefits (mandatory) * • Award or benefit notification letters prepared and signed by authorizing agency.	• Current or recent check stubs with date, amount, and check number recorded by the owner. • Award *or benefit* letters or computer printout from court or public agency. • Most recent quarterly pension account statement.	• Telephone or in-person contact with income source, documented in file by the owner. • **NOTE:** For all oral verification, file documentation must include facts, time and date of contact, and name and title of third party.	• Copies of validated bank deposit slips or bank statements, with identification by bank.	• Notarized statement of income received other than wages.	• *It is mandatory that the EIV Income Report be used as third-party verification of the Social Security benefit income received (24 CFR 5.233).* • Checks or automatic bank deposit slips may not provide gross amounts of benefits if applicant has deductions made for Medicare Insurance. • Pay stubs for the most recent four to six weeks should be obtained. • Copying of U.S. Treasury checks is not permitted. • Award letters/printouts from court or public agency may be out of date; telephone verification of letter/printout is recommended.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Interest from sale of real property (e.g., contract for deed, installment sales contract, etc.) *(See chapter 5, Paragraph 5-7.G.7)*	• Verification form completed by an accountant, attorney, real estate broker, the buyer, or a financial institution which has copies of the amortization schedule from which interest income for the next 12 months can be obtained.	• Copy of the contract.	• Telephone or in-person contact with appropriate party, documented in file by the owner.	• Copy of the amortization schedule, with sufficient information for the owner to determine the amount of interest to be earned during the next 12 months. • **NOTE:** Copy of a check paid by the buyer to the applicant is not acceptable.	• Notarized statement of interest from sale of real property.	• Only the interest income is counted; the balance of the payment applied to the principal is merely a liquidation of the asset. • The owner must get enough information to compute the actual interest income for the next 12 months.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Medical expenses. *(See Chapter 5, Paragraph 5-10.D)*	• Verification by a doctor, hospital or clinic, dentist, pharmacist, etc., of estimated medical costs to be incurred or regular payments expected to be made on outstanding bills which are not covered by insurance.	• Copies of income tax forms (Schedule A, IRS Form 1040) that itemize medical expenses, when the expenses are not expected to change over the next 12 months. • Receipts, or pay stubs, which indicate health insurance premium costs, or payments to a resident attendant. • Receipts or ticket stubs that verify transportation expenses directly related to medical expenses.	• Telephone or in-person contact with these sources, documented in file by the owner.	• Copies of cancelled checks that verify payments on outstanding medical bills that will continue for all or part of the next 12 months. • Cancelled checks which indicate health insurance premium costs, or payments to a resident attendant.	• Notarized statement or signed affidavit of transportation expenses directly related to medical treatment, if there is no other source of verification.	• Medical expenses are not allowable as deduction unless applicant is an elderly or disabled family. Status must be verified.
• Need for an assistive animal. *(See Chapter 3, Paragraph 3-29)*	• Letter from *appropriate third party unless the need is readily apparent or already known*.					• If the owner's policy is to verify this need, owner must implement policy consistently.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Net Income for a business *(See Chapter 5, Paragraph 5-6.H).*	• Not applicable.	• Form 1040 with Schedule C, E, or F. • Financial Statement(s) of the business (audited or unaudited) including an accountant's calculation of straight-line depreciation expense if accelerated depreciation was used on the tax return or financial statement. • For rental property, copies of recent rent checks, lease and receipts for expenses, or IRS Schedule E.	• Not applicable.	• Any loan application listing income derived from business during the preceding 12 months.	• Notarized statement showing net income for a business.	
• Recurring contributions and gifts. *(See Chapter 5, Paragraph 5-6.G)*	• Notarized statement or affidavit signed by the person providing the assistance giving the purpose, dates, and value of gifts.	• Not applicable.	• Telephone or in-person contact with source documented in file by the owner.	• Not applicable.	• Notarized statement or affidavit signed by applicant stating purpose, dates, and value of gifts.	• Sporadic contributions and gifts are not counted as income.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Self-employment, tips, gratuities, etc. *(See Paragraph 5-5.C and Paragraph 5-6.H)*	• None available.	• Form 1040/1040A showing amount earned and employment period.	• None available.		• Notarized statement or affidavit signed by applicant showing amount earned and pay period.	

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Social security number. *(See Chapter 3, Paragraph 3-31)*	• None required.		• None Required	• Original Social Security card • *Original document issued by a federal or state government agency which contains the name, SSN, and other identifying information of the individual* • Driver's license with SSN • Identification card issued by a medical insurance provider, or by an employer or trade union. • Earnings statements on payroll stubs • Bank statement • Form 1099 • Benefit award letter • Retirement benefit letter • Life insurance policy • Court records	• N/A	• Individuals who have applied for legalization under the Immigration Reform and Control Act of 1986 will be able to disclose their social security numbers but unable to supply cards for documentation. Social security numbers are assigned to these persons when they apply for amnesty. The cards go to DHS until the persons are granted temporary lawful resident status. Until that time, their acceptable documentation is a letter from the DHS indicating that social security numbers have been assigned.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• *Student Status (Section 8 only) (See Chapter 3, Paragraphs 3-13.A and 3-33.A)*	• *Enrolled full-time and/or part-time at an institution of higher education • Verification of independence from parents • Financial assistance received*				• *Signed declaration and certification of income from parents • Certification of income provided by parent or from persons not living in the unit with the student*	• *May also need to verify age; dependent children; marital status; tuition; veteran status and /or disability status.*
• *Student status (Section 221(d)(3) BMIR, Section 202 PAC, Section 202 PRAC and Section 811 PRAC) See Chapter 3, Paragraph 3-13.B and 3-33.B)*	• *Enrolled full-time and/or part-time at an institution of higher education • Verification of independence from parents • Financial assistance received*				• *Certification of income provided by parent or from persons not living in the unit with the student*	
• Unborn children.	• None required.		• None required.	• None required.	• Applicant/tenant self-certifies to pregnancy.	• Owner may not verify further than self-certification.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Unemployment compensation. *(See Chapter 5, Paragraphs 5-5.A, 5-6.J and Q)*	• *EIV Income Report (mandatory) * • Verification form completed by source.	• Copies of checks or records from agency provided by applicant stating payment amounts and dates. • Benefit notification letter signed by authorizing agency.	• Telephone or in-person contact with agency documented in a file by an owner.		• Notarized statement of unemployment compensation received.	• *It is mandatory that the EIV Income Report be used as third-party verification of employment and income (24 CFR 5.233).* • Frequency of payments and expected length of benefit term must be verified. • Income not expected to last full 12 months must be calculated based on 12 months and interim recertification completed when benefits stop.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Appendix 3: Acceptable Forms of Verification

Factor to be Verified	ACCEPTABLE SOURCES					Verification Tips
	Third Party[a]			*Provided by Applicant	Self-Declaration	
	Written [b and d]	*Provided by Applicant[e]	Oral[c]			
• Welfare payments (as-paid states only). *(See Chapter 5, Paragraph 5-6.K)*	• Verification form completed by welfare department indicating maximum amount family may receive. • Maximum shelter schedule by household size with ratable reduction schedule.		• Telephone or in-person contact with income source, documented in file by the owner.	• Maximum shelter allowance schedule with ratable reduction schedule provided by applicant.	• Notarized statement of welfare payments received.	• Actual welfare benefit amount not sufficient as proof of income in "as-paid" states or localities since income is defined as maximum shelter amount.
• Zero Income. *(See Chapter 9, Paragraph 9-11.D)*	• Not applicable.	• Not applicable.	• Not applicable.	• Not applicable.	• Applicant/Tenant self-certifies to zero income.	• Owners may require applicant/tenant to sign verification release of information forms for state, local, and federal benefits programs, as well as the HUD 9887 and HUD 9887-A. • Owners may require the tenant to reverify zero income status at least every 90 days.

[a]**NOTE**: Requests for verification from *a third party source* must be accompanied by a Consent to Release form *HUD-9887-A*.
[b]**NOTE**: If the original document is witnessed but is a document that should not be copied, the owner should record the type of document, any control or serial numbers, and the issuer. The owner should also initial and date this notation in the file.
[c]**NOTE**: For all oral verification, file documentation must include facts, time and date of contact, and name and title of the third party.
[d*]**NOTE:** For use of EIV Income Reports as third party verification of employment and income a current Consent for Release form HUD-9887 must be on file.*
[c*]**NOTE:** See examples and requirements found in Paragraph 5-13.B.1

Section 23

HUD 4350.3 REV-1 Chapter 5:
Determining Income and
Calculating Rent

CHAPTER 5. DETERMINING INCOME AND CALCULATING RENT

5-1 Introduction

A. Owners must determine the amount of a family's income before the family is allowed to move into assisted housing and at least annually thereafter. The amount of assistance paid on behalf of the family is calculated using the family's annual income less allowable deductions. HUD program regulations specify the types and amounts of income and deductions to be included in the calculation of annual and adjusted income.

B. Although the definitions of annual and adjusted income used for the programs covered in this handbook have some similarities with rules used by the U.S. Internal Revenue Service (IRS), the tax rules are different from the HUD program rules.

C. The most frequent errors encountered in reviews of annual and adjusted income determinations in tenant files fall in three categories:

1. Applicants and tenants failing to fully disclose income information;

2. Errors in identifying required income exclusions; and

3. Incorrect calculations of deductions, often the result of failure to obtain third-party verification.

Careful interviewing and thorough verification can minimize the occurrence of these errors.

D. Chapter 5 is organized as follows:

- **Section 1: Determining Annual Income** discusses the requirements regarding annual income and the procedure for calculating a family's annual income when determining eligibility. This section also includes guidance on determining income from assets.

- **Section 2: Determining Adjusted Income** describes the procedures and requirements for determining adjusted income based on allowable deductions.

- **Section 3: Verification** presents the requirements for verifying information provided by applicants and tenants related to their eligibility.

- **Section 4: Calculating Tenant Rent** discusses the methods for calculating the tenant's portion of rent under the different programs covered by this handbook.

5-2 Key Terms

A. There are a number of technical terms used in this chapter that have very specific definitions established by federal statute or regulations, or by HUD. These terms are listed in Figure 5-1 and their definitions can be found in the Glossary to this handbook. It is important to be familiar with these definitions when reading this chapter.

B. The terms disability and persons with disabilities are used in two contexts for civil rights protections, and for program eligibility purposes. Each use has specific definitions.

1. When used in context of protection from discrimination or improving the accessibility of housing, the civil rights-related definitions apply.

2. When used in the context of eligibility under multifamily subsidized housing programs, the program eligibility definitions apply.

NOTE: See the Glossary for specific definitions and paragraph 2-23 for an explanation of this difference.

Figure 5-1: Key Terms

• Adjusted income	• Live-in aide
• Annual income	• Low-income family
• Assets	• Market rent
• Assistance payment	• Minimum rent
• Assisted rent	• Operating rent
• Assisted tenant	• Project Assistance Contract (PAC)
• Basic rent	• PRAC Operating Rent
• Co-head of household	• Project Rental Assistance Contract (PRAC)
• Contract rent	• Project assistance payment
• Dependent	• Project rental assistance payment
• *Enterprise Income Verification (EIV)*	• Tenant rent
• Extremely low-income family	• Total tenant payment
• Foster adult	• Unearned income
• Foster children	• Utility allowance
• Full-time student	• Utility reimbursement
• Gross rent	• Very low-income family
• Hardship exemption	• Welfare assistance
• Head of household	• Welfare rent
• Housing assistance payment (HAP)	
• Income limit	

Section 1: Determining Annual Income

5-3 Key Regulations

This paragraph identifies the key regulatory citation pertaining to Section 1: Determining Annual Income. The citation and its title are listed below.

- *24 CFR 5.233 Mandated Use of HUD's Enterprise Income Verification (EIV) System*
- 24 CFR 5.609 Annual Income

5-4 Key Requirements

A. Annual income is the amount of income that is used to determine a family's eligibility for assistance. Annual income is defined as follows:

1. All amounts, monetary or not, that go to or are received on behalf of the family head, spouse or co-head (even if the family member is temporarily absent), or any other family member; or

2. All amounts anticipated to be received from a source outside the family during the 12-month period following admission or annual recertification effective date.

B. Annual income includes all amounts that are not specifically excluded by regulation. Exhibit 5-1, Income Inclusions and Exclusions, provides a list of income inclusions and exclusions published in the regulations and *Federal Register* notices.

C. Annual income includes amounts derived (during the 12-month period) from assets to which any member of the family has access.

5-5 Methods for Projecting and Calculating Annual Income

A. The requirements for determining whether a family is eligible for assistance, and the amount of rent the family will pay, require the owner to project or estimate the annual income that the family expects to receive. There are several ways to make this projection. The following are acceptable methods for calculating the annual income anticipated for the coming year:

1. Generally the owner must use current circumstances to anticipate income. The owner calculates projected annual income by annualizing *current* income. Income that may not last for a full 12 months (e.g., unemployment compensation) should be calculated assuming current circumstances will last a full 12 months. If changes occur later in the year, an interim recertification can be conducted to change the family's rent.

2. If information is available on changes expected to occur during the year, use that information to determine the total *anticipated* income from all known sources during the year.

3. *Using EIV:

   (a) The owner must not use the quarterly wage income reported on the EIV Income Report for calculating the tenant's annual income from employment. The owner must confirm with the tenant that the information in EIV is correct. If the tenant agrees that the employment information reported in EIV is correct, the owner must:

      (1) Use the Income Report as third party verification of the tenant's employment; and

      (2) Use tenant provided documents for calculating the tenant's annual income, e.g. 4-6 current, consecutive check stubs.

Example 1: EIV shows that John is working at Jack's Restaurant and John agrees that he is working there. John has brought in his four most current, consecutive check stubs. The owner must use the EIV Income Report as third party verification that John is employed at Jack's Restaurant and use the gross pay shown on the check stubs provided by the tenant for determining John's annual income. John is paid weekly.

Check stubs gross pay 1) $120; 2) $145; 3) $125; 4) $130 total gross pay = $520

$520 / 4 = $130 average gross pay per week

$130 x 52 weeks = $6,760 gross annual income

Example 2: EIV shows Sally works at Beauty World and Sally agrees that she is working there. Sally has brought in a payroll summary report prepared by her employer which shows that Sally works 30 hours per week and earns $12.50 per hour. The owner must use the EIV Income Report as third party verification that Sally is employed at Beauty World and use the payroll summary report prepared by Beauty World for determining Sally's annual income.

30 hours x 52 weeks = 1,560 hours per year

$12.50 per hour x 1,560 hours = $19,500 gross annual income

b. The owner must not use the quarterly unemployment compensation benefits reported on the EIV Income Report for calculating the tenant's annual income from unemployment. The owner must confirm with the tenant that the unemployment information in EIV is correct. If the tenant agrees that he/she is receiving unemployment compensation benefits as reported in EIV, the owner must:

(1) Use the Income Report as third party verification that the tenant is receiving unemployment; and

(2) Use tenant provided documents for calculating annual income, e.g. unemployment monetary benefit notice.

Example: Peter has brought in the unemployment benefit notice he received showing he is being paid weekly unemployment benefits of $175. The owner will use the EIV Income Report as third party verification that Peter is receiving unemployment benefits and the unemployment benefit notice for determining Peter's annual income.

$175 per week x 52 weeks = $9,100.00 gross annual income

NOTE: If Peter's unemployment is terminated during the annual recertification period, Peter should report this to the owner along with documentation supporting the date of termination of the benefits. The owner will then prepare an interim recertification removing the unemployment income. If Peter is unable to provide documentation verifying termination of unemployment compensation benefits, the owner must verify the termination directly with the state workforce agency (SWA) source.

c. If the tenant agrees with the social security benefit information on the EIV Income Report, the owner must use the EIV Income Report as third party verification, receiving social security benefits and also for calculating the tenant's annual income.

Example: The Income Report shows that Joe Smith is receiving gross social security benefits of $980.40 per month. Joe agrees that this is the amount he is receiving. The owner will use the Income Report as third-party verification that Joe is receiving social security benefits and for calculating Joe's annual income.

$980.40 x 12 months = $11,764.80 (rounded to $11,765) gross annual income.

d. If the tenant disputes the employment and income information in EIV, the owner must obtain third party verification from the source.*

B. Once all sources of income are known and verified, owners must convert reported income to an annual figure. Convert periodic wages to annual income by multiplying:

1. Hourly wages by the number of hours worked per year (2,080 hours for full-time employment with a 40-hour week and no overtime);

2. Weekly wages by 52;

3. Bi-weekly wages (paid every other week) by 26;

4. Semi-monthly wages (paid twice each month) by 24; and

5. Monthly wages by 12.

To annualize other than full-time income, multiply the wages by the actual number of hours or weeks the person is expected to work.

Example – Anticipated Increase in Hourly Rate

February 1	Certification effective date
$7.50/hour	Current hourly rate
$8.00/hour	New rate to be effective March 15

(40 hours per week x 52 weeks = 2,080 hours per year)

February 1 through March 15 =	6 weeks
6 weeks x 40 hours =	240 hours
2,080 hours minus 240 hours =	1,840 hours

(check: 240 hours + 1,840 hours = 2,080 hours)

Annual Income is calculated as follows:

240 hours x $7.50 =	$1,800	
$1,840 hours x $8.00 =	$14,720	
Annual Income		$16,520

(See **Appendix 8** for an explanation of the correct approach to rounding numbers.)

C. Some circumstances present more than the usual challenges to estimating anticipated income. Examples of challenging situations include a family that has sporadic work or seasonal income or a tenant who is self-employed. In all instances, owners are expected to make a reasonable judgment as to the most reliable approach to estimating what the tenant will receive during the year. In many of these challenging situations, midyear or interim recertifications may be

required to reflect changing circumstances. Some examples of approaches to more complex situations are provided below.

Examples – Irregular Employment Income

Seasonal work. Clyde Kunkel is a roofer. He works from April through September. He does not work in rain or windstorms. His employer is able to provide information showing the total number of regular and overtime hours Clyde worked during the past three years. To calculate Clyde's anticipated income, use the average number of regular hours over the past three years times his current regular pay rate, and the average overtime hours times his current overtime rate.

Sporadic work. Justine Cowan is not always well enough to work full-time. When she is well, she works as a typist with a temporary agency. Last year was a good year and she worked a total of nearly six months. This year, however, she has more medical problems and does not know when or how much she will be able to work. Because she is not working at the time of her recertification, it will be best to exclude her employment income and remind her that she must return for an interim recertification when she resumes work.

Examples – Irregular Employment Income

Sporadic work. Sam Daniels receives social security disability. He reports that he works as a handyman periodically. He cannot remember when or how often he worked last year: he says it was a couple of times. Sam's earnings appear to fit into the category of nonrecurring, sporadic income that is not included in annual income. Tell Sam that his earnings are not being included in annual income this year, but he must report to the owner any regular work or steady jobs he takes.

Self-employment income. Mary James sells beauty products door-to-door on consignment. She makes most of her money in the months prior to Christmas but has some income throughout the year. She has no formal records of her income other than a copy of the IRS Form 1040 she files each year. With no other information available, the owner will use the income reflected on Mary's copy of her form 1040 as her annual income.

5-6 Calculating Income—Elements of Annual Income

A. Income of Adults and Dependents

1. Figure 5-2 summarizes whose income is counted.

2. Adults. Count the annual income of the head, spouse or co-head, and other adult members of the family. In addition, persons under the age of 18 who have entered into a lease under state law are treated as adults, and their annual income must also be counted. These persons will be either the head, spouse, or co-head; they are sometimes referred to as emancipated minors.

   NOTE: If an emancipated minor is residing with a family as a member other than the head, spouse, or co-head, the individual would be considered a dependent and his or her income handled in accordance with subparagraph 3 below.

3. Dependents. A dependent is a family member who is under 18 years of age, is disabled, or is a full-time student

   The head of the family, spouse, co-head, foster child, or live-in aide are never dependents. Some income received on behalf of family dependents is counted and some is not.

   a. *Earned* income of minors (family members under 18) is not counted.

   b. Benefits or other *unearned* income of minors is counted.

Figure 5-2: Whose Income is Counted?

Members	**Employment Income**	**Other Income** (including income from assets)
Head	Yes	Yes
Spouse	Yes	Yes
Co-head	Yes	Yes
Other adult (including foster adult)	Yes	Yes
Dependents		
-Child under 18	No	Yes
Full-time student over 18	See Note	Yes
Foster child under 18	No	Yes
Nonmembers		
Live-in aide	No	No

NOTE: The earned income of a full-time student 18 years old or older who is a dependent is excluded to the extent that it exceeds $480.

c. When more than one family shares custody of a child, and both families live in assisted housing, only one family at a time can claim the dependent deduction. The family that counts the dependent deduction also counts the unearned income of the child. The other family claims neither the dependent deduction nor the unearned income of the child.

d. For full-time students, who are 18 years of age or older *and* are dependents, a small amount of their earned income will be counted. Count only earned income up to a maximum of $480 per year for full-time students, age 18 or older, who are not the head of the family; spouse or co-head.*If the earned income is less than $480 annually, count all of the income. If the earned income exceeds $480 annually,* count $480 and exclude the amount that exceeds $480.

e. The income of full-time students 18 years of age or older who are members of the household but away at school is counted the same as the income for other full-time students. The income of minors who are members of the household but away at school is counted as the income for other minors.

f. All income of a full-time student, 18 years of age or older, is counted if that person is the head of the family, spouse, or co-head.

g. Payments received by the family for the care of foster children or foster adults are *not* counted. This rule applies only to payments made through the official foster care relationships with local welfare agencies.

h. Adoption assistance payments in excess of $480 are not counted.

B. **Income of Temporarily Absent Family Members**

1. Owners must count all income of family members approved to reside in the unit, even if some members are temporarily absent.

2. If the owner determines that an absent person is no longer a family member, the individual must be removed from the lease and the HUD-50059.

3. A temporarily absent individual on active military duty must be removed from the family, and his or her income must not be counted unless that person is the head of the family, spouse, or co-head.

   a. However, if the spouse or a dependent of the person on active military duty resides in the unit, that person's income must be counted in full, even if the military member is not the head, or spouse of the head of the family.

b. The income of the head, spouse, or co-head will be counted even if that person is temporarily absent for active military duty.

Examples – Income of Temporarily Absent Family Members

- John Chouse works as an accountant. However, he suffers from a disability that periodically requires lengthy stays at a rehabilitation center. When he is confined to the rehabilitation center, he receives disability payments equaling 80% of his usual income.

  During the time he is not in the unit, he will continue to be considered a family member. The owner will conduct an interim recertification. Even though he is not currently in the unit, his total disability income will be counted as part of the family's annual income.

- Mirna Martinez accepts temporary employment in another location and needs a portion of her income to cover living expenses in the new location. The full amount of the income must be included in annual income.

- Charlotte Paul is on active military duty. Her permanent residence is her parents' assisted unit where her husband and children live. Charlotte is not currently exposed to hostile fire. Therefore, because her spouse and children are in the assisted unit, her military pay must be included in annual income. (If her dependents or spouse were not in the unit, she would not be considered a family member and her income would not be included in annual income.)

C. **Deployment of Military Personnel to Active Duty**

Owners are encouraged to be as lenient as responsibly possible to support affected households in situations where persons are called to active duty in the Armed Forces. Specific actions that owners should undertake to support military households include, but are not limited to:

1. Allow a guardian to move into the assisted unit on a temporary basis to provide care for any dependents the military person leaves in the unit. Income of the guardian temporarily living in the unit for this purpose is not counted as income.

2. Allow a tenant living in an assisted unit to provide care for any dependents of persons called to active duty in the Armed Forces on a temporary basis, as long as the head and/or co-head of household continues to serve in active duty. Income of the child (e.g., SSI benefits, military benefits) is not counted as income of the person providing the care.

3. Exclude from annual income special pay received by a household member serving in the Armed Services who is exposed to hostile fire (see Exhibit 5-1).

4. Give consideration for any case involving delayed payment of tenant rent. Determine whether it is appropriate to accept a late payment.

5. Allow the assistance payment and the lease to remain in effect for a reasonable period of time (depending on the length of deployment)

beyond that required by the Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C. §§ 501-591, even though the adult members of the military family are temporarily absent from the assisted unit.

D. **Income of Permanently Confined Family Members**

1. An individual permanently confined to a nursing home or hospital may not be named as family head, spouse, or co-head but may continue as a family member at the family's discretion. The family's decision on whether or not to include the permanently confined family member as a family member determines if that person's income will be counted.

   a. *Include* the individual as a family member and the income and allowable deductions related to the medical care of the permanently confined individual are counted; or

   b. *Exclude* the individual as a family member and the income and allowances based on the medical care of the permanently confined individual are not counted.

   If the family elects to include the permanently confined member, the individual is listed on the HUD-50059 as an adult who is not the head, spouse, or co-head, even when the permanently confined family member is married to the person who is or will become the head of the family. The owner should consider extenuating circumstances that may prevent the confined member from being able to sign the HUD-50059. If the owner determines the confined member is unable to sign the HUD-50059,he owner must document the file why the signature was not obtained. If the family elects not to include the permanently confined member, the individual would not be listed on the HUD-50059.

E. **Educational Scholarships or Grants**

All forms of student financial assistance (grants, scholarships, educational entitlements, work study programs, and financial aid packages) are excluded from annual income except for students receiving Section 8 assistance. This is true whether the assistance is paid to the student or directly to the educational institution

For students receiving Section 8 assistance, all financial assistance a student receives (1) under the Higher Education Act of 1965, (2) from private sources, or (3) from an institution of higher education that is in excess of amounts received for tuition is included in annual income except if the student is over the age of 23 with dependent children or the student is living with his or her parents who are receiving Section 8 assistance. See Paragraph 3-13 for further information on eligibility of students to receive Section 8 assistance and the Glossary for the definition of Student Financial Assistance.

F. Alimony or Child Support

Owners must count alimony or child support amounts awarded by the court unless the applicant certifies that payments are not being made *and* that he or she has taken all reasonable legal actions to collect amounts due, including filing with the appropriate courts or agencies responsible for enforcing payment.

1. The owner may accept printouts from the court or agency responsible for enforcing support payments, or other evidence indicating the frequency and amount of support payments actually received.

2. Child support paid to the custodial parent through a State child support enforcement or welfare agency may be included in the family's monthly welfare check and may be designated in different ways. In some states these payments are not identified as separate from the welfare grant. In these states, it is important to determine which portion is child support and not to count it twice. In other states, the payment may be listed as child support or as pass-through payments. These amounts must be counted as annual income.

3. When no documentation of child support, divorce, or separation is available, either because there was no marriage or for another reason, the owner may require the family to sign a certification stating the amount of child support received.

G. Regular Cash Contributions and Gifts

1. Owners must count as income any regular contributions and gifts from persons not living in the unit. These sources may include rent and utility payments paid on behalf of the family, and other cash or noncash contributions provided on a regular basis.

Examples – Regular Cash Contributions

- The father of a young single parent pays her monthly utility bills. On average he provides $100 each month. The $100 per month must be included in the family's annual income.

- The daughter of an elderly tenant pays her mother's $175 share of rent each month. The $175 value must be included in the tenant's annual income.

2. Groceries and/or contributions paid directly to the childcare provider by persons not living in the unit are excluded from annual income.

3. Temporary, nonrecurring, or sporadic income (including gifts) is not counted.

H. Income from a Business

When calculating annual income, owners must include the net income from operation of a business or profession including self-employment income. Net income is gross income less business expenses, interest on loans, and depreciation computed on a straight-line basis.

1. In addition to net income, owners must count any salaries or other amounts distributed to family members from the business, and cash or assets withdrawn by family members, except when the withdrawal is a reimbursement of cash or assets invested in the business.

2. When calculating net income, owners must not deduct principal payments on loans, interest on loans for business expansion or capital improvements, other expenses for business expansion, or outlays for capital improvements.

3. If the net income from a business is negative, it must be counted as zero income. A negative amount must not be used to offset other family income.

I. Periodic Social Security Payments

Count the gross amount, before deductions for Medicare, etc., of periodic Social Security payments. Include payments received by adults on behalf of individuals under the age of 18 or by individuals under the age of 18 for their own support. *See Section J below regarding adjustments for overpayment of benefits and Section O for calculating the income for tenants in ICF/MR or ICF/DD projects and assisted living units in elderly projects.*

> ***Example:** Mary's gross social security benefit is $700 per month. The owner calculates annual income by annualizing the gross monthly social security benefit amount.
>
> $700 per month x 12 months = $8,400 gross annual income.*

J. Adjustments for Prior Overpayment of Benefits

If an agency is reducing a family's benefits to adjust for a prior overpayment (e.g., social security, SSI, TANF, or unemployment benefits), count the amount that is actually provided after the adjustment.

Example – Adjustment for Prior Overpayment of Benefits

Lee Park's social security payment of $250 per month is being reduced by $25 per month for a period of six months to make up for a prior overpayment. Count his social security income as $225 per month for the next six months and as $250 per month for the remaining six months.

K. Public Assistance Income in As-Paid Localities

1. Special calculations of public assistance income are required for as-paid state, county, or local public assistance programs. An as-paid system is one:

   a. In which the family receives an amount from a public agency specifically for shelter and utilities; and

   b. In which the amount is adjusted based upon the actual amount the family pays for shelter and utilities.

2. The public assistance amount specifically designated for rent and utilities is called the welfare rent.

3. To determine annual income for public assistance recipients in as-paid localities, include the following:

   a. The amount of the family's grant for other than shelter and utilities; and

   b. The maximum amount the welfare department can pay for shelter and utilities for a family of that size (i.e., the welfare rent). This may be different from the amount the family is actually receiving.

4. Each as-paid locality works somewhat differently, and many are subject to court-ordered modifications to the basic policy. Owners should discuss how the rules are applied with the HUD Field Office.

Example – Welfare Income in "As Paid" Localities

At application, a family's welfare grant is $300, which includes $125 for basic needs and $175 for shelter and utilities (based upon where the family is now living). However, the maximum the welfare agency could allow for shelter and utilities for this size family is $190.

Count the following as income:

$125	Amount family receives for basic needs
$190	Maximum for shelter and utilities
$315	Monthly public assistance income

L. **Periodic Payments from Long-Term Care Insurance, Pensions, Annuities, and Disability or Death Benefits**

1. The full amount of periodic payments from annuities, insurance policies, retirement funds, pensions, and disability or death benefits is included in annual income. (See subparagraph O below for information on the withdrawal of cash or assets from an investment.) Payments such as Black Lung Sick Benefits, Veterans Disability, and Dependent Indemnity Compensation for the Widow of a Killed in Action Serviceman are examples of such periodic payments.

2. Withdrawals from retirement savings accounts such as Individual Retirement Accounts and 401K accounts that are not periodic payments do not fall in this category and are not counted in annual income (see paragraph 5.6.L.3).

Example – Withdrawals from IRAs or 401K Accounts

Isaac Freeman retired recently. He has an IRA account but is not receiving periodic payments from it because his pension is adequate for his routine expenses. However, he has withdrawn $2,000 for a trip with his children. The withdrawal is not a periodic payment and is not counted as income.

3. If the tenant is receiving long-term care insurance payments, any payments in excess of $180 per day must be counted toward the gross annual income. (**NOTE:** Payment of long-term care insurance premiums are an eligible medical expense see paragraph 5-10 D.8.k.)

4. Federal Government/Uniformed Services pension funds paid to a former spouse.

Federal Government/Uniformed Services pension funds paid directly to an applicant's/tenant's former spouse pursuant to the terms of a court decree of divorce, annulment, or legal separation are not counted as annual income. The state court has, in the settlement of the parties' marital assets, determined the extent to which each party shares in the ownership of the pension. That portion of the pension that is ordered by the court (and authorized by the Office of Personnel Management (OPM), to be paid to the applicant's/tenant's former spouse is no longer an asset of the applicant/tenant and therefore is not counted as income. However, any pension funds authorized by OPM, pursuant to a court order to be paid to the former spouse of a Federal government employee, is counted as income for a tenant/applicant receiving such funds.

Example: Joan Carson is a retired Federal government employee receiving a retirement pension. She is also the recipient of Section 8 housing assistance and involved in a divorce proceeding. In settling the assets of the marriage between Mrs. Carson and her former husband, the court ordered that one half of her pension be paid directly to her former husband in the amount of $20,000. The court provided OPM with clear, specific and express instructions acceptable for OPM to process the payment to Mrs. Carson's former husband. OPM authorized the payment of pension benefits to Mrs. Carson's former husband in the amount of $20,000. The $20,000 represents an asset disposed of as a result of a court decree. At the interim reexamination of her income, Mrs. Carson indicated a change in her income due to the court ordered payment of pension benefits to her former husband. The PHA requested that Mrs. Carson provide a copy of her statement from OPM evidencing the payment of pension benefits to her (her statement reflected the line item payment to her former husband due to the court order). That portion of the pension paid to her former husband no longer belongs to Mrs. Carson and is not counted as income.

The OPM is responsible for handling court orders (any judgments or property settlements issued by or approved by any court of any state, the District of Columbia, the Commonwealth of Puerto Rico, Guam, The Northern Mariana Islands, or the Virgin Islands in connection with the divorce, annulment of marriage, or legal separation of a Federal government employee or retiree) affecting current and retired Federal government employees. See 5 C.F.R. § 838.103. OPM must comply with court orders, decrees, or court-approved property settlement agreements in connection with divorces, annulments of marriage, or legal separations of employees that award a portion of the former Federal government employee's retirement benefits. Id. at § 838.101(a)(1). State courts ordering a judgment or property settlement in connection with divorce, annulment of marriage, or legal separation have the responsibility of issuing clear, specific, and express instructions to OPM with regards to providing benefits to former spouses. Id. at § 838.122. In response to instructions from state courts, OPM will authorize payments to the former spouses. Id. at § 838.121. Once the payments have been authorized by OPM, the reduced pension amount paid to the retired

Federal employee (the tenant/applicant) will be reflected in the tenant's/applicant's statement from OPM. Former spouses of Federal government employees receiving court ordered pension benefits are provided a Form-1099 reflecting pension benefits received from the retired Federal government employee. In verifying the income of tenants/applicants, owners should require that tenants/applicants provide any copies of statements from OPM verifying pension benefits (including any reductions pursuant to a court order, decree or court-approved property settlement agreement), and any evidence of survivor benefits, pensions or annuities received from retired Federal government employees including, but not limited to, a Form-1099. (See Paragraph 5-7.G.5 for more information on the treatment of income from Federal government pensions.)

5. Other State, local government, social security or private pensions paid to a former spouse.

   Other state, local government, social security or private pension funds paid directly to an applicant's/tenant's former spouse pursuant to the terms of a court decree of divorce, annulment, or legal separation are also not counted as annual income and should be handled in the same manner as 4, above. The decree and copies of statements should be obtained in order to verify the net amount of the pension that should be applied in order to determine eligibility and calculate rent.

M. **Income from Training Programs**

1. Amounts received under HUD-funded training programs are excluded from annual income.

2. Incremental earnings and benefits received by any family member due to participation in qualifying state or local employment training programs are excluded. Income from training programs not affiliated with a local government, and income from the training of a family member resident to serve on the management staff, is also excluded.

   a. Excluded income must be received under employment training programs with clearly defined goals and objectives and for a specific, limited time period. The initial enrollment must not exceed one year, although income earned during extensions for additional specific time periods may also be eligible for exclusion

   b. Training income may be excluded only for the period during which the family member participates in the employment training program.

   c. Exclusions include stipends, wages, transportation or child care payments, or reimbursements.

   d. Income received as compensation for employment is excluded only if the employment is a component of a job training program.

Once training is completed, the employment income becomes income that is counted.

e. Amounts received during the training period from sources that are unrelated to the job training program, such as welfare benefits, social security payments, or other employment, are not excluded.

2. Owners may ask to use project funds or funds from the Residual Receipts account to underwrite all or a portion of the cost of developing, maintaining, and managing a job training program for project residents if funds are available.

a. The Field Office will make the determination if the job training program may be approved, and if project funds are sufficient to fund the job training program and maintain the physical and financial integrity of the project. Job training programs may be either on-site at the project or off-site. For example, job training programs that have partnerships with local colleges, community based organizations, or local business, may have in-house job training programs designed for project residents.

b. Funds that an owner may choose to use to underwrite a job training program may include Section 8 funds, Community Development Block Grant funds, or housing authority funds. These funds may be used to cover the costs of various components of a job training program, including course materials, computer software, computer hardware, or personnel costs. Also, contractors and subcontractors, in connection with work performed under a Flexible Subsidy contract, may elect to hire project residents to perform certain skills required under the contract. If the employment of the project residents was pursuant to an apprenticeship program, this could constitute a training program using HUD funds, and income received by the tenants in the apprenticeship program will qualify as an exclusion from income.

N. Resident Services Stipends

Resident services stipends are generally modest amounts of money received by residents for performing services such as hall monitoring, fire patrol, lawn maintenance, and resident management.

1. If the resident stipend exceeds $200 per month, owners must include the entire amount in annual income.

2. If the resident stipend is $200 or less per month, owners must exclude the resident services stipend from annual income.

O. **Income Received by a Resident of an Intermediate Care Facility for the Mentally Retarded or for the Developmentally Disabled (ICF/MR or ICF/DD) and Assisted Living Units in Elderly Projects**

1. An intermediate care facility is a group home for mentally retarded or developmentally disabled individuals (ICF/MR or ICF/DD). The term intermediate care facility is one used by state mental health departments for group homes serving these residents.

2. Assisted living units are units in projects developed for elderly residents with project-based assistance that have been converted to assisted living units.

3. The local agency responsible for Medicaid provides funds directly to group home operators and assisted living providers for services.

4. Annual income at an ICF/MR, ICF/DD, or assisted living unit must include:

   a. The SSI payment a tenant receives or the facility receives on behalf of the tenant; plus

   b. All other income the tenant receives from sources other than SSI that are not excluded from income by HUD regulations (see Exhibit 5-1). Examples of other sources of income include wages, pensions, income from sheltered workshops, income from a trust, or other interest income.

   c. The personal allowance of an individual residing in an ICF/MR or ICF/DD is not included in annual income. If the owner is unable to determine the actual amount of the personal allowance, use $30.

5. Annual income does not include the enhanced benefit portion of the SSI that is provided to pay for services. In some instances, a resident's SSI income may be reduced between annual recertifications if the resident's earnings exceed a specified amount. If this happens, the resident may request an interim recertification.

P. **Withdrawal of Cash or Assets from an Investment**

The withdrawal of cash or assets from an investment received as periodic payments should be counted as income. Lump sum receipts from pension and retirement funds are counted as assets. If benefits are received through periodic payments, do not count any remaining amounts in the account as an asset. See Paragraph 5-7 for guidance on calculating income from an asset.

Q. **Lump Sum Payments Counted as Income**

1. Generally, lump sum amounts received by a family, such as inheritances, insurance settlements, or proceeds from sale of property are considered assets, not income.

2. When social security or SSI benefit income is paid in a lump sum as a result of deferred periodic payments, that amount is *excluded* from annual income.

3. *For Section 8 tenants only, any deferred Department of Veterans Affairs (VA) disability benefits that are received in a lump sum or in prospective monthly amounts are *excluded* from annual income.*

4. Settlement payments from claim disputes over welfare, unemployment, or similar benefits may be counted as assets, but lump sum payments caused by *delays in processing* periodic payments for unemployment or welfare assistance are included as income.

   How lump sum payments for delayed start of benefits are counted depends upon the following:

   a. When the family reports the change;

   b. When an interim re-examination is conducted; and

   c. Whether the family's income increases or decreases as a result.

   A lump sum payment resulting from delayed benefit income may be treated in either of the two ways illustrated in the example shown in Figure 5-3.

5. Lottery winnings paid in one payment are treated as assets. Lottery winnings *paid in periodic payments* must be counted as income.

Figure 5-3: Treatment of Delayed Benefit Payments Received in a Lump Sum

Family member loses his/her job on October 19 and applies for unemployment benefits. The family receives a lump sum payment of $700 in December to cover the period from 10/20 to 12/5 and begins to receive $100 a week effective 12/6.

Option A: The owner processes one interim re-examination immediately effective 11/1 and a second interim after unemployment benefits are known.

	10/1	11/1	12/1	1/1	2/1
Monthly gross income	800	*0	*0	492**	492**
Monthly allowances (three minors x 480 / 12 months)	120	-	-	120	120
Monthly adjusted income	680	0	0	372	372
Total tenant payment (TTP)	204	25	25	25***	112***

* The family's income is calculated at $0/month beginning November 1, continuing until benefits actually begin and new income is calculated. TTP is set at the minimum rent.

** Family's actual income for 1/1 is $100/week x 52 weeks $5,200 / 12 $433.

However, because the family's TTP was calculated at zero income for the months of November and December (the period eventually covered by the $700 lump sum payment), the annual income to be used in calculating monthly gross income should be as follows:

$100/week benefit x 52 weeks = $5,200 + $700 lump sum payment = $5,900 annual gross income/ 12 = $492.

*** Increased rent does not start until 2/1 in order to give the family notice of rent increase.

Option B: The owner processes one interim re-examination after unemployment benefits are known.

	10/1	11/1	12/1	1/1	2/1
Monthly gross income	800	0/800*	0/800*	433*	433*
Monthly allowances (three minors x 480 / 12 Months)	120	120	120	120	120
Monthly adjusted income	680	0/680	0/680	313	313
Total tenant payment	204	204*	204*	94	94
Recalculated TTP	-	94***	94*	94	94
Rent credit (204 94=)	-	110	110	-	-

* Family's actual income for 11/1 and 12/1 is zero, but because the owner does not process an interim re-examination, the family's TTP continues to be calculated using $800 as monthly gross income. Beginning 1/1, monthly gross income is known to be $100/week, or $433/month.

** The lump sum payment is taken into account by making the recertification retroactive to 11/1. Annual income is calculated as $5,200 / 12 = $433 monthly gross income.

*** TTP for November and December recalculated as $433 monthly gross income and $313 monthly adjusted income x .30 = 94 with credit or refund to family of $110/month for each of these two months for difference between TTP paid of $204 and recalculated TTP of $94.

R. Exclusions from Income

1. Regulations for the multifamily subsidized housing programs covered by this handbook specifically exclude certain types of income from annual income. However, many of the items listed as exclusions from annual income under HUD requirements are items that the IRS includes as taxable income. Therefore, it is important for owners to focus specifically on the HUD program requirements regarding annual income.

2. Among the items that are excluded from annual income is the value of food provided through:

   a. The Meals on Wheels program, food stamps, or other programs that provide food for the needy;

   b. Groceries provided by persons not living in the household; and

   c. Amounts received under the School Lunch Act and the Child Nutrition Act of 1966, including reduced lunches and food under the Special Supplemental Food Program for Women, Infants and Children (WIC).

Examples – Income Exclusions

- The Value of Food Provided through the Meals on Wheels Program or Other Programs Providing Food for the Needy. Jack Love receives a hot lunch each day during the week in the community room and an evening meal in his apartment. One meal is provided through the Meals on Wheels program. A local church provides the other. The value of the meals he receives is not counted as income.
- Groceries provided by persons not living in the household. Carrie Sue Colby's mother purchases and delivers groceries each week for Carrie Sue and her two year old. The value of these groceries is not counted as income despite the fact that these are a regular contribution or gift.
- Amounts Received Under WIC or the School Lunch Act. Lydia Jeffries' two children receive a free breakfast and reduced priced lunches at school every day through the Special Supplemental Food Program for Women, Infants and Children (WIC). The value of this food is not counted as income.

3. Some additional examples of income that are excluded from the calculation of annual income follow.

Examples – Income Exclusions

- Resident service stipends. Rich Fuller receives $50 a month for distributing flyers for management. This amount is excluded from annual income.

- Deferred periodic payments of social security benefits. Germain Johnson received $32,000 in deferred social security benefits following a lengthy eligibility dispute. This delayed payment of social security benefits is treated as an asset, not as income.

- Income from training programs. Jennifer Jones is participating in a qualified state-supported employment training program every afternoon to learn improved computer skills. Each morning, she continues her regular job as a typist. The $250 a week she receives as a part-time typist is included in annual income. The $150 a week she receives for participation in the training program is excluded in annual income.

- Earned Income Tax Credit refund payments. Mary Frances Jackson is eligible for an earned income tax credit. She receives payments from her employer each quarter because of the tax credit. These payments are excluded in annual income.

5-7 Calculating Income from Assets

Annual income includes amounts derived from assets to which family members have access.

A. What is Considered an Asset?

1. Assets are items of value that may be turned into cash. A savings account is a cash asset. The bank pays interest on the asset. The interest is the *income* from that asset.

2. Some tenants have assets that are not earning interest. A quantity of money under a mattress is an asset: it is a thing of value that could be used to the benefit of the tenant, but under the mattress it is not producing income.

3. Some belongings of value are not considered assets. Necessary personal property is not counted as an asset. Exhibit 5-2 summarizes the items that are considered assets and those that are not.

B. Determining Income from Assets

Note: For families receiving only BMIR assistance, it is not necessary to determine whether family assets exceed $5,000. The rule for imputing income from assets does not apply to the BMIR program.

1. The calculation to determine the amount of income from assets to include in annual income considers both of the following:

   a. The total cash value of the family's assets; and

   b. The amount of income those assets are earning or could earn.

2. The rule for calculating income from assets differs depending on whether the total cash value of family assets is $5,000 or less, or is more than $5,000.

C. **Determining the Total Cash Value of Family Assets**

1. To comply with the rule for determining the amount of income from assets, it is necessary to first determine whether the total cash value of family assets exceeds $5,000.

   a. The cash value of an asset is the market value less reasonable expenses that would be incurred in selling or converting the asset to cash, such as the following:

      (1) Penalties for premature withdrawal;

      (2) Broker and legal fees; and

      (3) Settlement costs for real estate transactions.

      The cash value is the amount the family could actually receive in cash, if the family converted an asset to cash.

Example – Calculating the Cash Value of an Asset

A family has a certificate of deposit (CD) in the amount of $5,000 paying interest at 4%. The penalty for early withdrawal is three months of interest.

$5,000 x 0.04 = $200 in annual income

$200/12 months = $16.67 interest per month

$16.67 x 3 months = $50.01

$5,000 - $50 = $4,950 cash value of CD

   b. It is essential to note that a family is not required to convert an asset to cash. Determining the cash value of the asset is done simply as a calculation by the owner because it is a required step when determining income from assets under program requirements.

D. **Assets Owned Jointly**

1. If assets are owned by more than one person, prorate the assets according to the percentage of ownership. If no percentage is specified or provided by a state or local law, prorate the assets evenly among all owners.

2. If an asset is not effectively owned by an individual, do not count it as an asset. An asset is not effectively owned when the asset is held in an individual's name, but (a) the asset and any income it earns accrue to the benefit of someone else who is not a member of the family, and (b) that other person is responsible for income taxes incurred on income generated by the assets.

3. Determining which individuals have ownership of an asset requires collecting as much information as is available and making the best judgment possible based on that information.

Example – Determining the Cash Value of an Asset

The cash value of an asset is the amount a family would receive if the family turned a noncash asset into cash.

The cash value is the market value—or the amount another person would pay to acquire the asset—less the cost to turn the asset into cash.

If a family owns real estate, it may be necessary to consider the family's equity in the property as well as the expense to sell the property.

To determine the family's equity, subtract amounts owed on the property from its market value:

Market value
\- Mortgage amount owed
Equity in the property

Calculate the cash value by subtracting the expense of selling the property:

Equity
\- Expense of selling
Cash Value

Juanita Player owns a rental house. The market value is $100,000. She owes $60,000. The cost to dispose of this house would be $8,000. The owner would determine the cash value as follows:

Market Value	$100,000
Mortgage amount	- $60,000
	40,000
Cost of disposing of the asset (real estate commission, and other costs of sale)	- $8,000
Cash Value	**$32,000**

a. In some instances, but not all, knowing whose social security number is connected with the asset may help in identifying ownership. Owners should be aware that there are many situations in which a social security number connected with an asset does not indicate ownership and other situations where there is ownership without connection to a social security number.

b. Determining who has contributed to an asset or who is paying taxes on the asset may assist in identifying ownership.

Examples – Jointly Owned Assets

- Helen Wright is an assisted-housing tenant. She and her daughter, Elsie Duncan, have a joint savings account. Mother and daughter both contribute to the account. They have used the account for trips together and to cover emergency needs for either of them. Assume in this example that state law does not specify ownership. Even though either Helen Wright or Elsie Duncan could withdraw the entire asset for her own use, count Helen's ownership as 50% of the account.
- Jean Boucher's name is on her mother's savings account to ensure that she can access the funds for her mother's care. The account is not effectively owned by Jean and should not be counted as her asset.

E. Calculating Income from Assets When Assets Total $5,000 or Less

If the total cash value of all the family's assets is $5,000 or less, the actual income the family receives from assets is the amount that is included in annual income as income from assets.

F. Calculating Income from Assets When Assets Exceed $5,000

1. When net family assets are more than $5,000, annual income includes the greater of the following:

   a. Actual income from assets; or

   b. A percentage of the value of family assets based upon the current passbook savings rate as established by HUD. This is called *imputed* income from assets. The passbook rate is currently set at 2%.

2. To begin this calculation, first add the cash value of all assets. Multiply the total cash value of all assets by .02. The product is the imputed income from assets. Then, add the actual income from all assets. The greater of the imputed income from assets or the actual income from assets is included in the calculation of annual income.

Example – Use Actual Income from Assets When Total Net Family Assets are $5,000 or Less

Type of Asset	Cash Value	Actual Yearly Income
Certificate of Deposit $1,000 withdrawal fee $50 interest @ 4%	$950	$40
Savings Account $500 interest @ 2.5%	$500	$13
Stock $300 Not paying dividends	$300	$0
Total	$1,750	$53

The total cash value of the family's assets is $1,750. Therefore, the amount that is added to annual income as income from assets is the actual income earned or $53.

Example – Imputed Income from Assets

Imputed means attributed or assigned. Imputing income from assets is assigning an amount of income solely for the sake of the annual income calculation. The imputed income is not real income.

For example, money under a mattress is not earning income. If the money were put in a savings account it would earn interest. Imputed income from such an asset is the interest the money would earn if it were put in a savings account.

A family with cash under a mattress is not required to put the cash in a savings account; but when the owner is calculating income for a family with more than $5,000 in assets, the owner must assign an amount that cash would earn if it were in a savings account.

Example – Determining Income from Assets When Net Family Assets Exceed $5,000

Type of Asset	Cash Value	Actual Yearly Income
Checking Account (non-interest bearing)	$455	$0
Savings Account (interest at 2.5%)	$6,000	$150
Stocks (not paying dividends this year)	$3,000	$0
Total	$9,455	$150

Total cash value of assets is greater than $5,000. Therefore, it is necessary to compare the actual income from assets to the imputed income from assets.

The total cash value of assets ($9,455) is multiplied by 2% to determine the imputed income from assets.

.02 x $9,455 = $189

$189 is greater than the actual income from assets ($150).

In this case, therefore, the owner will add $189 to the annual income calculation as income from assets.

G. **Calculating Income from Assets - Specific Types of Assets**

1. Trusts.

a. Explanation of trusts.

(1) A trust is a legal arrangement generally regulated by state law in which one party (the creator or grantor) transfers property to a second party (the trustee) who holds the property for the benefit of one or more third parties (the beneficiaries). A trust can contain cash or other liquid assets or real or personal property that could be turned into cash. Generally, the assets are invested for the benefit of the beneficiaries.

(2) Trusts may be revocable or nonrevocable. A revocable trust is a trust that the creator of the trust may amend or end (revoke). When there is a revocable trust, the creator has access to the funds in the trust account. When the creator sets up a nonrevocable trust, the creator has no access to the funds in the account.

(3) The beneficiary frequently will be unable to touch any of the trust funds until a specified date or event (e.g., the

beneficiary's 21st birthday or the grantor's death). In some instances, the beneficiary may receive the regular investment income from the trust but not be able to withdraw any of the principal.

(4) The beneficiary and the grantor may be members of the same family. A parent or grandparent may have placed funds in trust to a child. If the trust is revocable, the funds may be accessible to the parent or grandparent but not to the child.

b. How to treat trusts.

(1) The basis for determining how to treat trusts relies on information about who has access to either the principal in the account or the income from the account.

(2) Revocable trusts. If any member of the tenant family has the right to withdraw the funds in the account, the trust is considered to be an asset and is treated as any other asset. The cash value of the trust (the amount the family member would receive if he or she withdrew all that could be withdrawn) is added to total net assets. The actual income received is added to actual income from assets.

Example – A Trust Accessible to Family Members

Assez Charaf lives alone. He has placed $20,000 in trust to his grandson to be available to the grandson upon the death of Assez. The trust is revocable, that is, Assez has control of the principal and interest in the account and can amend the trust or remove the funds at any time. In calculating Assez's income, the owner will add the $20,000 to Assez's net family assets and the actual income received on the trust to actual income from assets.

(3) Nonrevocable trusts. If no family member has access to either the principal or income of the trust at the current time, the trust is not included in the calculation of income from assets or in annual income.

If only the income (and none of the principal) from the trust is currently available to a family member, the income is counted in annual income, but the trust is not included in the calculation of income from assets.

(4) Nonrevocable trust as an asset disposed of for less than fair market value. If a tenant sets up a nonrevocable trust for the benefit of another person while residing in assisted

housing, the trust is considered an asset disposed of for less than fair market value (see subparagraph G.6 below).

– If the trust has been set up so income from the trust is regularly reinvested in the trust and is not paid back to the creator, the trust is calculated as any other asset disposed of for less than fair market value for two years and not taken into consideration thereafter.

Example – Nonrevocable Trust As an Asset Disposed of for Less Than Fair Market Value

Sarah Gordy placed $100,000 in a nonrevocable trust for her grandson. Last year, the trust produced $8,000, which was reinvested into the trust.

The trust is treated as an asset disposed of for less than fair market value for two years. (See paragraph 5.7 G.6.) No actual income from the trust is included in Sarah's annual income, but the value of the asset when it was given away, $100,000, is included in net family assets for two years from the date the trust was established.

– Nonrevocable trust distributing income. When a tenant places an asset in a nonrevocable trust but continues to receive income from the trust, the income is added to annual income *and* the trust is counted as an asset disposed of for less than market value for two years. Following the two-year period, the owner will count only the actual income distributed from the trust to the tenant.

Example – Nonrevocable Trust Distributing Income to the Creator/Tenant

Reggie Bouchard has established a nonrevocable trust in the amount of $35,000 that no one in the tenant family controls. Income from the trust is paid to Reggie. Last year, he received $3,500.

The owner will count Reggie's actual anticipated income from the trust in next year's annual income.

Because the asset was disposed of for less than fair market value (see paragraph 5.7 G.6), the value of the asset given away, $35,000, is counted as an asset disposed of for less than fair market value for two years.

(5) Payment of principal from a trust. The beneficiary of a trust may receive funds from the trust in different ways. A beneficiary may receive the full value of a trust at one time. In that instance the funds would be considered a lump sum receipt and would be treated as an asset. A trust set up to provide support for a person with disabilities may pay only income from the trust on a periodic basis. Occasionally, however, a beneficiary may be given a portion of the trust principal on a periodic basis. When the principal is paid out on a periodic basis, those payments are considered regular income or gifts and are counted in annual income.

Example – Payment of Principal Amounts from a Trust

Jared Leland receives funds from a nonrevocable trust established by his parents for his support. Last year he received $18,000 from the trust. The attorney managing the trust reported that $3,500 of the funds distributed was interest income and $14,500 was from principal. Jared receives a payment of $1,500 each month (an amount that includes both principal and interest from the trust).

The owner will count the entire $18,000 Jared received as annual income.

c. Special needs trusts.

A special needs trust is a trust that may be created under some state laws, often by family members for disabled persons who are not able to make financial decisions for themselves. Generally, the assets within the trust are not accessible to the beneficiary.

(1) If the beneficiary does not have access to income from the trust, then it is not counted as part of income.

(2) If income from the trust is paid to the beneficiary regularly, those payments are counted as income.

Example – Special Needs Trust

Daryl Rockland is a 55-year-old person with disabilities, living with his elderly parents. The parents have established a special-needs trust to provide income for their son after they are gone. The trust is not revocable; neither the parents nor the son currently have access to the principal or interest. In calculating the income of the Rocklands, the owner will disregard the trust.

2. Annuities.

a. Annuity facts and terms.

(1) An annuity is a contract sold by an insurance company designed to provide payments, usually to a retired person, at specified intervals. Fixed annuities guarantee a certain payment amount, while variable annuities do not, but have the potential for greater returns.

– A hybrid annuity (also called a combination annuity) combines the features of a fixed annuity and a variable annuity.

– A deferred annuity is an annuity that delays income payments until the holder chooses to receive them. An immediate annuity is one that begins payments immediately upon purchase.

– A life annuity continues to pay out as long as the owner is alive. A single-life annuity provides income benefits for only one person. A joint life annuity is issued on two individuals, and payments continue in whole or in part as long as either individual is alive.

(2) Generally, a person who holds an annuity from which he or she is not yet receiving payments will also be earning income. In most instances, a fixed annuity will be earning interest at a specified fixed rate similar to interest earned by a CD. A variable annuity will earn (or lose) based on market fluctuations, as in a mutual fund.

(3) Most annuities charge surrender or withdrawal fees. In addition, early withdrawal usually results in tax penalties.

(4) Depending on the type of annuity and the current status of the annuity, the owner will need to ask different questions of the verification source, which will normally be the applicant or tenant's insurance broker.

b. Income after the holder begins receiving payments.

(1) When verifying an annuity, owners should ask the verification source whether the holder of the annuity has the right to withdraw the balance of the annuity. For annuities without this right, the annuity is not treated as an asset.

(2) Generally, when the holder has begun receiving annuity payments, the holder can no longer convert it to a lump sum of cash. In this situation, the holder will receive regular payments from the annuity that will be treated as regular income, and no calculations of income from assets will be made.

c. Calculations when an annuity is considered an asset.

(1) When an applicant or tenant has the option of withdrawing the balance in an annuity, the annuity will be treated like any other asset. It will be necessary to determine the cash value of the annuity in addition to determining the actual income earned.

(2) In most instances, an annuity from which payments have not yet been made is earning income on the balance in the annuity. A fixed annuity will earn income at a fixed rate in the same manner that a CD earns income. A variable annuity will earn (or lose) based on current market conditions, as with a mutual fund.

(3) The owner will need to verify with the insurance agent or other appropriate source:

– The right of the holder to withdraw the balance (even if penalties are involved).

– The basis on which the annuity may be expected to grow during the coming year.

– The surrender or early withdrawal penalty fee.

– The tax rate and the tax penalty that would apply if the family withdrew the annuity.

(4) The cash value will be the full value of the annuity, less the surrender (or withdrawal) penalty, and less any taxes and tax penalties that would be due.

(5) The actual income is the balance in the annuity times the percentage (either fixed or variable) at which the annuity is expected to grow over the coming year. (This money will be reinvested into the annuity, but it is still considered actual income.)

(6) The imputed income from the asset is calculated only after the cash value of all family assets has been determined.

Imputed income from assets is calculated on the total cash value of all family assets.

3. Lump sum receipts counted as assets.

a. Commonly, when a family receives a large amount of money, a lump sum payment, the family will put the money in a checking or savings account, or will purchase stocks or bonds or a CD. Owners must count lump sum payments received by a tenant as assets. Examples of lump sum payments include the following:

(1) Inheritances;

(2) Capital gains;

(3) Lottery winnings paid in one payment;

(4) Cash from the sale of assets;

(5) Insurance settlements (including health and accident insurance, workers compensation, and personal and property losses); and

(6) Any other amounts that are received in one-time lump sum payments.

Example – Calculating the Cash Value of an Annuity

Rodrigo Ramirez, site manager at Fernwood Forrest, has interviewed Barbara Barstow, an applicant who reports holding an annuity from which she will not receive payments for another 15 years when she turns 65. The applicant could not provide any more detail on the annuity but did report the name, address, and phone number of her insurance agent.

Rodrigo called the insurance agent and faxed a copy of the applicant's approval for release of information. As a result, Rodrigo learned that the annuity is a fixed annuity, with a current value of $20,400 earning interest at an annual rate of 4.5%. The applicant could withdraw the current balance in the account but would pay a surrender penalty of $3,000. If the annuity is withdrawn, then the applicant will owe $1,200 in tax penalties.

In this example, the important information for calculating cash value is the current value, $20,400; the surrender fee, $3,000; and the tax penalties, $1,200. If the applicant withdrew the cash from the annuity, after paying the surrender fee and tax penalty, then the amount of cash received would be $16,200.

The cash value, $16,200, is recorded as an asset.

Rodrigo will also calculate the actual anticipated income on this asset: $20,400 x .045 = $918.

b. A lump sum payment is counted as an asset only as long as the family continues to possess it. If the family uses the money for something that is not an asset—a car or a vacation or education—the lump sum must not be counted.

c. It is possible that a lump sum or an asset purchased with a lump sum payment may result in enough income to require the family to report the increased income before the next regularly scheduled annual recertification. But this requirement to report an increase in income before the next annual recertification would not apply if the income from the asset was not measurable by the tenant (e.g., gems, stamp collection).

Examples – Lump Sum Additions to Family Assets (One-Time Payment)

- JoAnne Wettig won $500 in the lottery and received it in one payment. Do not count the $500 as income. At JoAnne's next annual recertification, she will report all of her assets.

- Mia LaRue, a tenant in a Section 8 property, won $75,000 in one payment in the lottery. She buys a car with some of the money, and puts the remaining amount of $24,000 in the bank. Mia receives her first bank statement and notices that the income on this asset is $205 per month. She must report this increase in income because the family has experienced a cumulative increase in income of more than $200 per month. (See paragraph 7-10 A.4 on rules for reporting interim increases in income.) The owner must perform an interim recertification and count the greater of the actual or imputed income on this asset (since the net family assets are greater than $5,000).

4. Balances held in retirement accounts.

a. Balances held in retirement accounts are counted as assets if the money is accessible to the family member. For individuals still employed, accessible amounts are counted even if withdrawal would result in a penalty. However, amounts that would be accessible only if the person retired are not counted.

b. IRA, Keogh, and similar retirement savings accounts are counted as assets, even though withdrawal would result in a penalty, *unless benefits are being received through periodic payments.*

c. Include contributions to company retirement/pension funds:

(1) While an individual is employed, count only amounts the family can withdraw without retiring or terminating employment.

(2) After retiring or terminating employment, count as an asset any amount the employee elects to receive as a lump sum.

d. Include in *annual income* any retirement benefits received through periodic payments. *Do not count any remaining amounts in the account as an asset.*

Examples – Balances Held in an IRA or 401K Retirement Account

- Jed Dozier's 401K account balance is $35,000. He is able to terminate his participation in the retirement plan without quitting his job, but if he did so he would lose a part of his employer's contribution and would pay a penalty fee. The total cash he could withdraw, $18,000, is the amount that is counted as an asset.

5. Federal Government/Uniformed Services Pensions

In instances where the applicant/tenant is a retired Federal Government/Uniformed Services employee receiving a pension that is determined by a state court in a divorce, annulment of marriage, or legal separation proceeding to be a marital asset and the court provides OPM with the appropriate instructions to authorize OPM to provide payment of a portion of the retiree's pension to a former spouse, that portion to be paid directly to the former spouse is not counted as income for the applicant/tenant. However, where the tenant/applicant is the former spouse of a retired Federal Government/Uniformed Services employee, any amounts received pursuant to a court ordered settlement in connection with a divorce, annulment of marriage, or legal separation are reflected on a Form-1099 and is counted as income for the applicant/tenant. (See Paragraph 5-6.K.4 for more information on Federal Government/Uniformed Services pension funds paid to a former spouse.)

6. Other state, local government, social security or private pensions.

Other state, local government, social security or private pensions where pensions are reduced due to a court ordered settlement in connection with a divorce, annulment of marriage, or legal separation and paid directly to the former spouse are not counted as income for the applicant/tenant and should be handled in the same manner as 5, above.

7. Mortgage or deed of trust.

a. Occasionally, when an individual sells a piece of real estate, the seller may loan money to the purchaser through a mortgage or deed of trust. This may be referred to as a contract sale.

b. A mortgage or deed of trust held by a family member is included as an asset. Payments on this type of asset are often received as one combined payment that includes interest and principal. The value of the asset is the unpaid principal as of the effective date of the certification. Each year this balance will decline as more principal is paid off. The interest portion of the payment is counted as actual income from an asset.

8. Assets disposed of for less than fair market value. Applicants and tenants must declare whether an asset has been disposed of for less than fair market value at each certification and recertification. Owners must count assets disposed of for less than fair market value during the two years preceding certification or recertification. The amount counted as an asset is the difference between the cash value and the amount actually received. (This provision does not apply to families receiving only BMIR assistance.)

a. Any asset that is disposed of for less than its full value is counted, including cash gifts as well as property. To determine the amount that has been given away, owners must compare the cash value of the asset to any amount received in compensation.

b. However, the rule applies only when the fair market value of all assets given away during the past two years exceeds the gross amount received by more than $1,000.

Examples – Assets of More or Less Than $1,000 Disposed of for Less Than Fair Market Value

- During the past two years, Alexis Turner donated $300 to the local food bank, $150 to a camp program, and $200 to her church. The total amount she disposed of for less than fair market value is $650. Since the total is less than $1,000, the donations are not treated as assets disposed of for less than fair market value.
- Jackson Jones gave each of his three children $500. Because the total exceeds $1,000, the gifts are treated as assets disposed of for less than fair market value.

c. When the two-year period expires, the income assigned to the disposed asset also expires. If the two-year period ends in the middle of a recertification year, the tenant may request an interim recertification to remove the disposed asset(s). However, if the owner elects to only include the income for a partial remaining year as shown in the example below, an interim recertification should not be conducted.

Example – Asset Disposed of for Less Than Fair Market Value

Margot Lundberg's recertification will be effective January 1. On that date, it will be 18 months since she sold her house to her daughter for $60,000 less than its value. The owner will count income on the $60,000 for only six months. (After six months, the two-year limit on assets disposed of for less than fair market value will have expired.)

d. Assets disposed of for less than fair market value as a result of foreclosure, bankruptcy, divorces, or separation, are *not* counted.

e. Assets placed in nonrevocable trusts are considered as assets disposed of for less than fair market value except when the assets placed in trust were received through settlements or judgments.

f. Applicants and tenants must sign a self-verification form at their initial certification and each annual recertification identifying all assets that have been disposed of for less than fair market value or certifying that no assets have been disposed of for less than fair market value.

g. Owners need to verify the tenant self certification only if the information does not appear to agree with other information reported by the tenant/applicant.

Examples – Asset Disposed of for Less Than Market Value

(1) An applicant sold her home to her daughter for $10,000. The home was valued at $89,000 and had no loans secured against it. Broker fees and settlement costs are estimated at $1,800.

$89,000	Market value
- 1,800	Fees
$87,200	Cash value
- 10,000	Sales price to daughter
$77,200	Asset disposed of for less than fair market value

In this example, the asset disposed of for less than fair market value is $77,200. That amount is counted as the resident's asset for two years from the date the sale took place.

(The $10,000 received from the daughter may currently be in a savings account or other asset or may have been spent. The $10,000 will be counted as an asset if the applicant has not spent the money.)

(2) A resident contributed $10,000 to her grandson's college tuition and gave her two granddaughters $4,000 each to save for college.

$10,000	College tuition gift
+ 8,000	Gift to granddaughters
$18,000	Asset disposed of for less than fair market value

The $18,000 disposed of for less than fair market value is counted as the tenant's asset for two years from the date each asset was given away.

Section 2: Determining Adjusted Income

Section 2 does not apply to families applying for or occupying 221(d)(3) BMIR units without additional subsidy.

5-8 Key Regulations

This paragraph identifies the key regulatory citation pertaining to Section 2: Determining Adjusted Income. The citation and its topic are listed below.

- 24 CFR 5.611 Adjusted Income

5-9 Key Requirements for Determining Adjusted Income

A. There are five possible deductions that may be subtracted from annual income based on allowable family expenses and family characteristics. The remainder, after these deductions are subtracted, is called adjusted income. Adjusted income is generally the amount upon which rent is based. See Section 4 of this chapter for information about specific rent calculation methods. This section focuses on the calculation of annual adjusted income. Before rent is calculated, annual adjusted income is converted to monthly adjusted income.

B. Of the five possible deductions, three are available to any assisted family, and two are permitted only for elderly or disabled families.

1. The three types of deductions available to any assisted family are:

   a. A deduction for dependents;

   b. A child care deduction; and

   c. A disability assistance deduction.

2. The two types of deductions permitted only for families in which the head, spouse, or co-head is elderly or disabled are:

   a. An elderly/disabled family deduction; and

   b. A deduction for unreimbursed medical expenses.

   NOTE: A family may not designate a family member as head or co-head solely to become eligible for these additional benefits. The remaining member of a family listed in paragraph 5-9 B.2 who is not 62 or older or a person with disabilities is not eligible for these allowances.

5-10 Calculating Adjusted Income

A. **Dependent Deduction**

1. A family receives a deduction of $480 for each family member *(except foster children and foster adults)* who is:

   a. Under 18 years of age;

   b. A person with disabilities; or

   c. A full-time student of any age.

   It is not necessary for a member of the family to have legal custody of a dependent in order to receive the dependent deduction.

2. Some family members may never qualify as dependents regardless of age, disability, or student status.

a. The head of the family, the spouse, and the co-head may never qualify as dependents.

b. A foster child, *foster adult*, an unborn child, a child who has not yet joined the family or a live-in aide may never be counted as a dependent.

3. A full-time student is one who is carrying a full-time subject load at an institution with a degree or certificate program. A full-time load is defined by the institution where the student is enrolled.

4. When more than one family shares custody of a child and both live in assisted housing, only one family at a time can claim the dependent deduction for that child. The family with primary custody or with custody at the time of the initial certification or annual recertification receives the deduction. If there is a dispute about which family should claim the dependent deduction, the owner should refer to available documents such as copies of court orders or an IRS return showing which family has claimed the child for income tax purposes.

B. **Child Care Deduction**

1. Anticipated expenses for the care of children under age 13 (including foster children) may be deducted from annual income if all of the following are true:

a. The care is necessary to enable a family member to work, seek employment, or further his/her education (academic or vocational).

b. The family has determined there is no adult family member capable of providing care during the hours care is needed.

c. The expenses are not paid to a family member living in the unit.

d. The amount deducted reflects reasonable charges for child care.

e. The expense is not reimbursed by an agency or individual outside the family.

f. Child care expenses incurred to permit a family member to work must not exceed the amount earned by the family member made available to work during the hours for which child care is paid.

2. When child care enables a family member to work or go to school, the rule limiting the deduction to the amount earned by the family member made available to work applies only to child care expenses incurred while the individual is at work. While that family member is at school or looking for work, the expense for child care is not limited.

Example – Child Care Deduction
Separate Expenses for Time at Work and Time at School

Bernice and Ernest have two children. Both parents work, but Bernice works only part-time and goes to school half time. She pays $4.00 an hour for eight hours of child care a day. For four of those hours, she is at work; for four of them she attends school. She receives no reimbursement for her child care expense.

Her annual expense for child care during the hours she works is $4,000. Her annual expense for the hours she is at school is also $4,000. She earns $6,000 a year. Ernest earns $18,000.

The rule requires that Bernice's child care expense while she is working not exceed the amount she is earning while at work. In this case, that is not a problem. Bernice earns $6,000 during the time she is paying $4,000. Therefore, her deduction for the hours while she is working is $4,000.

Bernice's expense while she is at school is not compared to her earnings. Her expense during those hours is $4,000, and her deduction for those hours will also be $4,000.

Bernice's total child care deduction is $8,000 ($4,000 $4,000). The total deduction exceeds the amount of Bernice's total earnings, but the amount she pays during the hours she works does not exceed her earnings.

If Bernice's child care costs for the hours while she works were greater than her earnings, she would not be able to deduct all of her child care costs.

Bernice is paying a total of $8,000 in child care expenses. Of that expense, payments of $4,000 cover the hours while she is in school; payments of $4,000 cover the hours she works. If Bernice were earning $3,500, her total child care deduction for the hours she works would be capped at the amount of money she earns. In this case, the total deduction would be $7,500 ($4,000 for expenses while she is in school plus $3,500 of the amount she pays while she is working.)

3. Child care attributable to the work of a full-time student (except for head, spouse, co-head) is limited to not more than $480, since the employment income of full-time students in excess of $480 is not counted in the annual income calculation. Child care payments on behalf of a minor who is not living in the applicant's household cannot be deducted.

4. Child care expenses incurred by two assisted households with split custody can be split between the two households when the custody and expense is documented for each household and the documentation demonstrates that the total expense claimed by the two households does not exceed the cost for the actual time the child spends in care.

C. Deduction for Disability Assistance Expense

1. Families are entitled to a deduction for unreimbursed, anticipated costs for attendant care and auxiliary apparatus for each family member who is a person with disabilities, to the extent these expenses are reasonable and necessary to enable any family member 18 years of age or older who may or may not be the member who is a person with disabilities to be employed.

Examples – Eligible Disability Assistance Expenses

The payments made on a motorized wheelchair for the 42-year-old son of the head of the family enable the son to leave the house and go to work each day on his own. Prior to the purchase of the motorized wheelchair, the son was unable to make the commute to work. These payments are an eligible disability assistance expense.

Payments to a care attendant to stay with a disabled 16-year-old child allow the child's mother to go to work every day. These payments are an eligible disability assistance expense.

2. This deduction is equal to the amount by which the cost of the care attendant or auxiliary apparatus exceeds 3 of the family's annual income. However, the deduction may not exceed the earned income received by the family member or members who are enabled to work by the attendant care or auxiliary apparatus.

3. If the disability assistance enables more than one person to be employed, the owner must consider the combined incomes of those persons. For example, if an auxiliary apparatus enables a person with a disability to be employed and frees another person to be employed, the allowance cannot exceed the combined incomes of those two people.

Example – Calculating a Deduction for Disability Assistance Expenses

Head's earned income	$14,500
Spouse's earned income	+$12,700
Total income	$27,200
Care expenses for disabled 15-year-old	$3,850
Calculation:	$3,850
(3% of annual income)	- $816
Allowable disability assistance expenses	$3,034

(**NOTE:** $3,034 is not greater than amount earned by spouse, who is enabled to work.)

4. Auxiliary apparatus includes items such as wheelchairs, ramps, adaptations to vehicles, or special equipment to enable a sight-impaired person to read or type, but only if these items are directly related to permitting the disabled person or other family member to work.

   a. Include payments on a specially-equipped van to the extent they exceed the payments that would be required on a car purchased for transportation of a person who does not have a disability.

   b. The cost of maintenance and upkeep of an auxiliary apparatus is considered a disability assistance expense (e.g., the veterinarian costs and food costs of a service animal; the cost of maintaining the equipment that is added to a car, but not the cost of maintaining the car).

   c. If the apparatus is not used exclusively by the person with a disability, the owner must prorate the total cost and allow a specific amount for disability assistance.

5. In addition to anticipated, ongoing expenses, one-time nonrecurring expenses of a current resident for auxiliary apparatus may be included in the calculation of the disability assistance expense deduction after the expense is incurred. These expenses may be added to the family's total disability assistance expense either at the time the expense occurs through an interim recertification or in the rent calculation during the following annual recertification.

6. Attendant care includes but is not limited to reasonable expenses for home medical care, nursing services, housekeeping and errand services, interpreters for hearing-impaired, and readers for persons with visual disabilities.

Example – Calculating a Deduction When Disability Assistance Expenses Exceed Related Earnings

Kenisha Prior, an individual with disabilities, lives with her mother Grace Prior. Her mother works full time. Kenisha works part time at the library. She requires a motorized wheelchair and special transportation to get to her job.

Grace Prior s Income	$24,000
Kenisha Prior's Income	+ 5,000
Total income	$29,000
Disability Assistance Expense	$8,000
(3% of annual income)	- $870
	$7,130

The $7,130 exceeds the amount Kenisha earns. The disability assistance deduction, therefore, is limited to the amount earned by the person made available to work or, in this case, $5,000.

7. When the same provider takes care of children and a disabled person over age 12, the owner must prorate the total cost and allocate a specific cost to attendant care. The sum of both child care and disability assistance expenses cannot exceed the employment income of the family member enabled to work.

Example – Calculating Child Care and Disability Assistance Deductions

Head's earned income	$8,300
Spouse's earned income	+ $6,700
Total income	$15,000

The family has two children: a 10-year-old son and a 15-year-old son who is disabled. One care provider, who charges $120 per week, cares for both sons. The care provider reports that the cost for caring for the 10-year-old is $50 a week and the cost of care for the child with disabilities is $70 a week.

Child care expense	$50 x 52 = $2,600
Total disability assistance expense	$70 x 52 = $3,640

Total disability assistance expense ($3,640) less 3% of annual income ($450) = $3,190

Child care deduction	$2,600
Disability assistance deduction	+$3,190
Total deductions	$5,790

Total deductions when compared to earnings must not exceed employment earnings of $6,700.

D. Medical Expense Deduction

1. The medical expense deduction is permitted only for families in which the head, spouse, or co-head is at least 62 years old or is a person with disabilities (elderly or disabled families).

2. If the family is eligible for a medical expense deduction, owners must include the unreimbursed medical expenses of all family members, including the expenses of nonelderly adults or children living in the family.

3. Medical expenses include all expenses the family anticipates to incur during the 12 months following certification/recertification that are not reimbursed by an outside source, such as insurance.

4. The owner may use the ongoing expenses the family paid in the 12 months preceding the certification/recertification to estimate anticipated medical expenses.

5. The medical expense deduction is that portion of total medical expenses that exceeds 3% of annual income.

Example – Calculating the Medical Expense Deduction

Age of head	64	Annual income	$12,000
Age of spouse	58	Total medical expenses	$1,500
		Sample Calculation	
		Annual income	$12,000
			x .03
		3% of annual income	$ 360
		Total medical expenses	$1,500
			- $360
		Allowable medical expenses	$ 1,140

6. In addition to anticipated expenses, past one-time nonrecurring medical expenses that have been paid in full may be included in the calculation of the medical expense deduction for current tenants at an initial, interim or annual recertification. Past one-time nonrecurring medical expenses that have been paid in full are not applicable when calculating anticipated medical expenses at move-in. If the tenant is under a payment plan, the expense would be counted as anticipated

   a. There are two options for addressing one-time medical expenses. These expenses may be added to the family's total medical expenses either: (1) at the time the expense occurs, through an interim recertification, or (2) at the upcoming annual recertification

      NOTE: If the one-time expense is added at an interim recertification, it cannot be added to expenses at the annual recertification.

   b. The following example illustrates the two options. Tenants may use either option.

The following example illustrates the two options. Tenants may use either option.
Example – One-Time, Nonrecurring Medical Expenses

Maria and Gustav Crumpler had a total of $2,932 in medical expenses last year (Year 1). Of this amount, $932 covered Gustav's gall bladder surgery; $2,000 was for routine costs that are expected to re-occur in the coming year. The entire amount may be included in the Crumpler's medical costs for the coming year (Year 2) despite the fact that the gall bladder surgery is a past event that is not likely to re-occur.

If, during the coming year (Year 2), the Crumplers experience additional one-time medical costs not anticipated at the annual recertification, they may request an interim recertification or wait for their next annual recertification (during Year 3) and ask for the unanticipated expenses to be included in the medical expense calculation for the following year.

The owner may wish to explain to residents that including past one-time medical expenses in an annual recertification rather than in an interim recertification will result in a rent reduction for a larger number of months.

For example, let us assume Maria has unanticipated dental surgery during Year 2 at a cost of $3,550 six months after the annual recertification. The Crumpler's current TTP is $560; their annual income is $25,000.

Annual income	$25,000
Less elderly household deduction	- $400
Less allowable medical deduction ($2,932 less 3% of $25,000)	- $2,182
Adjusted annual income	$22,418
Adjusted monthly income	$1,868
TTP	$560

If the Crumplers request an interim recertification, the $3,550 additional cost will lower their rent for 6 months; if they wait for their annual recertification, the cost of the dental surgery will affect their rent for 12 months.

Annual income	$25,000
Less elderly household deduction	- $400
Less allowable medical deduction ($6,482 less 3% of $25,000)	- $5,732
Adjusted annual income	$18,868
Adjusted monthly income	$1,572
TTP	$472

At the Crumplers' current annual income, the large dental bill reduces rent by $88.

OPTION #1: If the Year 2 rent is adjusted through an interim recertification, the Crumplers will save 6 months times $88 or $528.

OPTION #2: If the Crumplers wait until their annual recertification, the large bill will affect their rent for the 12 months of Year 3, and they will save twice as much, or $1,056.

7. When a family is making regular payments over time on a bill for a past one-time medical expense, those payments are included in anticipated medical expenses. However, if a family has received a deduction for the full amount of a medical bill it is paying over time, the family cannot continue to count that bill even if the bill has not yet been paid.

Example – Medical Expense Paid over a Period of Time

Ursula and Sebastian Grant did not have insurance to cover Sebastian's operation four years ago. They have been paying $105 a month toward the $5,040 debt. Each year that amount ($105 x 12 months or $1,260) has been included in their total medical expenses. A review of their file indicates that a total of $5,040 has been added to total medical expenses over the four-year period. However, the Grants bring a current invoice to their annual recertification interview. Over the four-year period they have missed five payments and still owe $525. Although they still owe this amount, the bill cannot be included in their current medical expenses because the expense has already been deducted.

8. Not all elderly or disabled applicants or participants are aware that their unreimbursed expenses for medical care are included in the calculation of adjusted income for elderly or disabled families. For that reason, it is important for owners to ask enough questions to obtain complete information about allowable medical expenses. The following list highlights some of the most common expenses that may be deducted. A list of examples of eligible medical expenses may be found in Exhibit 5-3.

   a. Services of doctors and health care professionals;

   b. Services of health care facilities;

   c. Medical insurance premiums or costs of an HMO;

   d. Prescription/nonprescription medicines that have been prescribed by a physician;

   e. Transportation to treatment;

   f. Dental expenses;

   g. Eyeglasses, hearing aids, batteries;

   h. Live-in or periodic medical assistance such as nursing services, or costs for an assistance animal and its upkeep;

   i. Monthly payments on accumulated medical bills;

   j. Medical care of a permanently institutionalized family member *if* his or her income is included in annual income; and

k. Long-term care insurance premiums. The family member paying a long-term care insurance premium must sign a certification (see Sample Certification for Qualified Long-Term Care Insurance Expenses in Exhibit 5-4) that states the insurance is guaranteed renewable, does not provide a cash surrender value, will not cover expenses covered under Medicare, and restricts the use of refunds. The certification must be maintained in the family's occupancy file. (Paragraph 5-6 L.3 describes situations in which long-term care insurance payments must be included in annual income.)

9. Special calculation for families eligible for disability assistance and medical expense deductions. If an elderly family has both unreimbursed medical expenses and disability assistance expenses, a special calculation is required to ensure that the family's 3 of income expenditure is applied only one time. Because the deduction for disability assistance expenses is limited by the amount earned by the person enabled to work, the disability deduction must be calculated before the medical deduction is calculated.

a. When a family has unreimbursed disability assistance expenses that are less than 3% of annual income, the family will receive no deduction for disability assistance expense. However, the deduction for medical expenses will be equal to the amount by which the sum of both disability and medical expenses exceeds 3% of annual income.

b. If the disability assistance expense exceeds the amount earned by the person who was enabled to work, the deduction for disability assistance will be capped at the amount earned by that individual. When the family is also eligible for a medical expense deduction, however, the 3% may have been exhausted in the first calculation, and it then will not be applied to medical expenses.

c. When a family has both disability assistance expenses and medical expenses, it is important to review the collected expenses to be sure no expense has been inadvertently included in both categories.

E. Elderly Family Deduction

An elderly or disabled family is any family in which the head, spouse, or co-head (or the sole member) is at least 62 years of age or a person with disabilities. Each elderly or disabled family receives a $400 family deduction. Because this is a family deduction each family receives only one deduction, even if both the head and spouse are elderly or disabled.

Example – Special Calculation for Families Who Are Eligible for Disability Assistance and Medical Expense Deductions

The following is basic information on the family:

Head (retired/disabled)—SS/pension income	$16,000
Spouse (employed)—employment income	+ $4,000
Total Annual Income	$20,000
Total disability assistance expenses	$500
Total medical expenses	$1,000

Step 1: Determine if the disability assistance expenses exceed 3% of the family's total annual income.

Total disability assistance expenses	$500
Minus 3% of total annual income	-$600
	($100)

No portion of the disability expenses exceeds 3% of the annual income; therefore, the disability assistance deduction is $0.

Step 2: Calculate if the medical expenses exceed the balance of 3 of the family's total annual income.

Total medical expenses	$1,000
Minus the balance of 3% of total annual income	- $100
Allowable medical expenses deduction	$900

F. **No Deduction for Alimony or Child Support Paid to a Person outside the Assisted Family**

There is no deduction for an amount paid to a person outside the assisted family for alimony or child support. Even if the amount is garnished from the wages of a family member, it must be included in annual income.

Example – Child Support Garnished from Wages

George Graevette pays $150 per month in child support. It is garnished from his monthly wages of $950. After the child support is deducted from his salary, he receives $800. The owner must count $950 as George's monthly income.

Section 3: Verification

5-11 Key Regulations

This paragraph identifies key regulatory citations pertaining to Section 3: Verification. The citations and their titles (or topics) are listed below.

A. 24 CFR part 5, subpart B Disclosure and Verification of Social Security Numbers and Employer Identification Numbers; Procedures for Obtaining Income Information

B. *24 CFR 5.233 Mandated Use of HUD's Enterprise Income Verification (EIV) System*

C. 24 CFR 5.659 Family Information and Verification

D. 24 CFR 8.24, 8.32, 100.204 (Reasonable accommodation)

5-12 Verification Requirements

A. **Key Requirements**

1. Owners must verify all income, assets, expenses, deductions, family characteristics, and circumstances that affect family eligibility or level of assistance.

2. *Owners must use the EIV Income Report for third party verification of a tenant's employment and income at the time of recertification (annual and interim) and to assist in reducing administrative and subsidy payment errors.*

3. Applicants and adult family members must sign consent forms to authorize the owner to collect information to verify eligibility, income, assets, expenses, and deductions. Applicants and tenants who do not sign required consent forms will not receive assistance.

4. *Household members must disclose and provide verification of their complete and accurate SSN except for those individuals who do not contend eligible immigration status, and tenants age 62 or older as of January 31, 2010, whose initial determination of eligibility was begun before January 31, 2010. See Paragraphs 3-9 and 3-31 for SSN disclosure and verification requirements.*

5. The owner must handle any information obtained to verify eligibility or income in accordance with the Privacy Act.

Figure 5-4: Privacy Act Notice

The Department of Housing and Urban Development (HUD) is authorized to collect this information by the U.S. Housing Act of 1937 (42 U.S.C. 1437 et. seq.), by Title VI of the Civil Rights Act of 1964 (42 U.S.C. 2000d), and by the Fair Housing Act (42 U.S.C. 3601-19). The Housing and Community Development Act of 1987 (42 U.S.C. 3543) requires applicants and participants to submit the social security number of each household member.

Purpose: Your income and other information are being collected by HUD to determine your eligibility, the appropriate bedroom size, and the amount your family will pay toward rent and utilities.

Other Uses: HUD uses your family income and other information to assist in managing and monitoring HUD-assisted housing programs, to protect the Government's financial interest, and to verify the accuracy of the information you provide. This information may be released to appropriate federal, state, and local agencies, when relevant, and to civil, criminal, or regulatory investigators and prosecutors. However, the information will not be otherwise disclosed or released outside of HUD, except as permitted or required by law.

Penalty: You must provide all of the information requested by the owner, including all social security numbers you, and all other household members, have and use. Giving the social security numbers of all household members is mandatory, and not providing the social security numbers will affect your eligibility. Failure to provide any of the requested information may result in a delay or rejection of your eligibility approval.

B. Timeframe for Conducting Verifications

Owners conduct verifications at the following three times.

1. Owners must verify income, assets, expenses, and deductions and all eligibility requirements prior to move-in.

2. Owners must verify each family's income, assets, expenses, and deductions as part of the annual recertification process. Refer to Chapter 7, Section 1 for information on annual recertifications.

3. Owners must verify changes in income, allowances, or family characteristics reported between annual recertifications. Refer to Chapter 7, Section 2 for information on interim recertifications.

5-13 Acceptable Verification Methods

A. Methods of Verification

Owners must use verification methods that are acceptable to HUD. The owner is responsible for determining if the verification documentation is adequate and credible. *Acceptable methods of verification, in order of acceptability: 1) upfront-income verification (UIV) with use of EIV being mandatory and use of non-EIV UIV being optional; 2) third-party verification from source (written), 3) third-party verification from source (oral), and 4) family certification.* If third-party verification is not available, owners must document the tenant file to explain why third-party verification was not available. **Appendix 3** provides a detailed list of acceptable forms of verification by type of information.

B. Third-Party Verification

1. *The following describes the types of third-party verification in order of acceptability

   a. Upfront-income verification (UIV)

      UIV is verification of income before or during a certification and/or recertification, through an independent source that systematically and uniformly maintains income information in a computerized form.

      (1) Using HUD's EIV system for tenants (not available for applicants). **(Mandatory)**

         It is mandatory that owners use the EIV system as the third-party source to verify employment and income information of tenants during recertification (annual and interim) of family composition and income.

      (2) UIV using non-EIV system **(Optional)**

         (a) Owners may use other non-HUD UIV tools such as The Work Number and other state government databases, if available, to verify income:

            (1) Of applicants;

            (2) When no employment or income is available in EIV; or

            (3) For other types of income received by the family.

b. Third-party verification from source (written)

(1) An original or authentic document generated by a third party source that is dated within 120 days from the date of receipt by the owner. Such documentation may be in possession of the tenant (or applicant), and commonly referred to as tenant-provided documents. These documents are considered third-party verification because they originated from a third-party source.

Examples of tenant-provided documentation that may be used includes, but is not limited to: pay stubs, payroll summary report, employer notice/letter of hire/termination, SSA benefit letter, bank statements, child support payment stubs, welfare benefit letters and/or printouts, and unemployment monetary benefit notices.

Owners must consider the following when using tenant-provided documentation:

(a) Is the document current? Documentation of public assistance may be inaccurate if it is not recent and does not show any changes in the family's benefits or work and training activities.

(b) Is the documentation complete? Owners may not accept pay stubs to document employment income unless the applicant or tenant provides the most recent four to six, consecutive pay stubs to illustrate variations in hours worked. Actual paychecks or copies of paychecks should never be used to document income because deductions are not shown on the paycheck.

(c) Is the document an unaltered original? The greatest shortcoming of tenant-provided documents as a verification source is their susceptibility to undetectable change through the use of high-quality copying equipment. Documents with original signatures are the most reliable. Photocopied documents generally cannot be assumed to be reliable.

(2) Written documentation sent directly by the third-party source by mail or electronically by fax, email or internet.

Note: See Paragraph 9-10 for situations when this method of verification must be used prior to verifying through (1) above.*

(For information about electronic documentation, see subparagraph B.2 below.)

c. *Third-party verification from source (oral).*

When verifying information over the telephone, it is important to be certain that the person on the telephone is the party he or she claims to be. Generally, it is best to telephone the verification source rather than to accept verification from a source calling the property management office. Oral verification must be documented in the file, as described in paragraph 5-18.C.

d. *Family Certification.

An owner may accept a tenant's notarized statement or signed affidavit regarding the veracity of information submitted only if the information cannot be verified by another acceptable verification method. In these instances, the owner must document the file why third-party verification was not available. (See Paragraph 5-18.E for documentation requirements when third-party verification is not available.). The owner may witness the tenant signature(s) in lieu of a notarized statement or affidavit.*

2. *The following describes use of electronic information when used as third-party verification.*

Electronic Verification. The owner may obtain accurate third-party written verification by facsimile, email, or Internet, if adequate effort is made to ensure that the sender is a valid third-party source.

a. Facsimile. Information sent by fax is most reliable if the owner and the verification source agree to use this method in advance during a telephone conversation. The fax should include the company name and fax number of the verification source.

b. Email. Similar to faxed information, information verified by email is more reliable when preceded by a telephone conversation and/or when the email address includes the name of an appropriate individual and firm.

c. Internet. Information verified on the Internet is considered third party verification if the owner is able to view web-based information from a reputable source on the computer screen. Use of a printout from the Internet may also be adequate verification in many instances. Refer to subparagraph C. Review of Documents below.

Example – Verification by Internet Printout

Jose Perez maintains a portfolio of stocks and bonds through an Internet-based stockbroker. The broker only provides electronic account statements and will not respond to a written verification request. The owner may accept a printout of Jose's most recent statement if it includes the relevant information required for third-party verification and an Internet address and header or footer that identifies the company issuing the statement. If the owner has reason to question the authenticity of a document, the owner may require Jose to access the electronic file via the Internet in the owner's office, without providing the owner with username or password information.

5-14 Identifying Appropriate Verification Sources

An owner must only collect information that is necessary to determine the applicant's or tenant's eligibility for assistance or level of assistance. **Appendix 3** provides a list of acceptable forms of third-party verification.

5-15 Required Verification and Consent Forms

A. Consent and Verification Forms

Adult members of assisted families must authorize owners to request independent verification of data required for program participation. To provide owners with this authorization, adult family members must sign two HUD-required consent forms plus the owner's specialized verification forms. Owners must create their own verification forms to request information from employers, child care providers, and others. Families sign these and the two HUD consent forms at the time of move-in certification and annual recertification. All adults in each assisted family must sign the required consent forms or the family must be denied assistance. Owners must give the family a copy of each form the family signed.

B. HUD-Required Consent and Release Forms

Applicants and tenants must sign two HUD-required consent forms.

1. Form HUD-9887, *Notice and Consent to the Release of Information to HUD and to a PHA*. Each adult member must sign the form regardless of whether he or she has income. Each family member who is at least 18 years of age and the head, spouse or co-head, regardless of age, must sign this form at move-in, initial and at each annual recertification. The form must also be signed when a new adult member joins the household. The form is valid for 15 months from the date of signature. The consent allows HUD or a public housing agency to verify information with the Internal Revenue Service *(IRS), the Social Security Administration (SSA), the Department of Health and Human Services (HHS') National Directory of New Hires (NDNH), and with state agencies that maintain wage and unemployment claim information (SWICAs).* Owners must

keep the original signed form in the tenant's file and provide a copy to the family. Exhibit 5-5 contains a copy of form HUD-9887.

2. Form HUD-9887-A, *Applicant's/Tenant's Consent to the Release of Information – Verification by Owners of Information Supplied by Individuals Who Apply for Housing Assistance*. Owners and the head of household, spouse, co-head, *regardless of age,* and each family member who is at least 18 years of age must sign a HUD-9887-A form at move-in and at each annual recertification. Each adult member must sign a form regardless of whether he or she has income. The consent allows owners to request and receive information from third-party sources about the applicant or tenant. Owners keep the original form in the tenant's file and provide a copy to the family. Exhibit 5-6 contains a copy of form HUD-9887-A.

C. **Information to Tenants**

Owners must provide applicants and tenants with the HUD Fact Sheet, a copy of the *Resident Rights and Responsibilities* brochure, *and a copy of the *EIV & You* brochure.*

1. HUD-9887 Fact Sheet. When applicants and tenants sign form HUD-9887 and form *HUD-9887-A*, owners must provide each family with a copy of the *HUD-9887/A* Fact Sheet. This Fact Sheet describes the verification requirements for applicants and tenants and the tenant protections that are part of the verification process. Exhibit 5-7 contains a copy of the *HUD-9887/A* Fact Sheet.

2. *Resident Rights and Responsibilities Brochure*. Owners must provide applicants and tenants with a copy of the *Resident Rights and Responsibilities* brochure at move-in and annually at recertification. *See Chapter 1, paragraph 1-7.B for information on obtaining copies of the brochure.*

3. **EIV & You* Brochure. Owners must provide applicants and tenants with a copy of the *EIV & You* brochure at move-in and annually at recertification. See Chapter 1, paragraph 1-7.B for information on obtaining copies of the brochure.*

D. **Owner-Created Verification Forms**

1. Owners must create verification forms for specific *verificat*ion needs and must include the language required by HUD as shown in Figure 5-5. **Appendix 6** contains instructions, a sample verification consent, and guidance about the types of information to request when verifying income and eligibility.

2. It is important that the applicant or tenant know whom owners will ask to provide information and to whom the completed form will be returned. Therefore, verification forms must clearly state in a prominent location that the applicant or tenant may not sign the consent if the form does not

clearly indicate who will provide the requested information and who will receive the information. When sending a request for verification to a third party, owners send the verification form with the applicant's or tenant's original signature to the third-party source. Owners must retain a copy of the verification form and provide a copy to the applicant or tenant upon request.

Figure 5-5: Language Required on all Consent Forms

The following statement must appear on all consent forms developed by owners:

Title 18, Section 1001 of the U.S. Code states that a person is guilty of a felony for knowingly and willingly making false or fraudulent statements to any department of the United States Government. HUD and any owner (or any employee of HUD or the owner) may be subject to penalties for unauthorized disclosures or improper use of information collected based on the consent form. Use of the information collected based on this verification form is restricted to the purposes cited above. Any person who knowingly or willingly requests, obtains or discloses any information under false pretenses concerning an applicant or participant may be subject to a misdemeanor and fined not more than $5,000. Any applicant or participant affected by negligent disclosure of information may bring civil action for damages, and seek other relief, as may be appropriate, against the officer or employee of HUD or the owner responsible for the unauthorized disclosure or improper use. Penalty provisions for misusing the social security number are contained in the Social Security Act at 208 (a) (6), (7) and (8). Violation of these provisions are cited as violations of 42 U.S.C. 408 (a) (6), (7) and (8)

5-16 Effective Term of Verifications

Verifications and consent forms must be used within a reasonable time. HUD has set specific limits on the duration of verification consents. In addition, verified information must be used in a timely manner since family circumstances are subject to change. HUD places several other limits on the information that may be requested and when and how it may be used.

A. Duration of Verification Authorization

Owner-created verification forms and the forms HUD-9887 and *HUD-9887-A* expire 15 months after they are signed. Owners must ensure that the forms HUD-9887 and *HUD-9887-A* have not expired when processing verifications. However, there are differences between the duration of form HUD-9887 and that of the individual verification forms.

1. The form HUD-9887-A and individual verification forms can be used during the 120 days before the certification period. During the certification period, however, these forms may be used only in cases

where the owner receives information indicating that the information the tenant has provided may be incorrect. Other uses are prohibited.

2. Owners may verify anticipated income using individual verification forms to gather prospective information when necessary (e.g., verifying seasonal employment). Historical information that owners may request using individual verification forms is restricted as follows:

   a. Information requested by individual verification forms is restricted to data that is no more than 12 months old.

   b. However, if the owner receives inconsistent information and has reason to believe that the information the applicant or tenant has supplied is incorrect, the owner may obtain information from any time in the last five years when the individual was receiving assistance, as provided by the form HUD-9887-A.

3. The form HUD-9887 may be used at any time during the entire 15 month period. The information covered by the form HUD-9887 is restricted as follows:

   a. State Wage Information Collection Agency (SWICA) Information received from SWICA is limited to wages and unemployment compensation the applicant or tenant received during the last five years she/he received housing assistance.

   b. *NDNH. Information received from HHS' NDNH is limited to wages and unemployment compensation received during period(s) within the last five years when the tenant has received assisted housing benefits.*

   c. Internal Revenue Service and Social Security Administration. form HUD-9887 authorizes release by IRS and SSA of data from only the current income tax return and IRS W-2 form.

      If the IRS, *NDNH* or SSA matches reveal that the tenant may have supplied inconsistent information, HUD may request that the tenant consent to the owner acquiring information on the last five years during the periods in which the tenant was receiving assistance.

B. **Effective Term of Verifications**

1. Verifications are valid for 120 days from the date of receipt by the owner, *not the effective date of the 50059.*

2. If verifications are more than 120 days old *from the date of receipt by the owner*, the owner must obtain new verifications.

3. Time limits do not apply to information that does not need to be reverified, such as:

a. Age;

b. Disability status;

c. Family membership; or

d. Citizenship status.

5-17 Inconsistent Information Obtained Through Verifications

An owner may not take any action to suspend, terminate, reduce or make a final denial of any benefits based on inconsistent information received during the verification process or when the tenant disputes information obtained until the owner has independently investigated the information. The owner *must* follow procedures for addressing errors and fraud and for terminating assistance in accordance with Chapter 8.

5-18 Documenting Verifications

A. Key Requirement

Owners must include verification documentation in the tenant file.

B. Documenting Third-Party Verification

All third-party verification documentation must be put in the tenant file, e.g., EIV Income Reports or verifications received from sources via mail, etc.

C. Documenting Telephone Verification

When verifying information by phone, the owner must record and include in the tenant's file the following information:

1. Third-party's name, position, and contact information;

2. Information reported by the third party;

3. Name of the person who conducted the telephone interview; and

4. Date and time of the telephone call.

D. Recording Inspection of Original Documents

Original documents should be photocopied, and the photocopy placed in the tenant file. *Originals of tenant-provided documents are to be returned to the tenant.* If the original document cannot be copied, a clear note to the file must describe the type of document, the information contained in the document, the name of the person who reviewed the document, and the date of that review.

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E. **Documenting Why Third-Party Verification Is Not Available**

When third-party verification is not available, owners must document in the file efforts made to obtain the required verification and the reason the verification was not obtained. The owner must include the following documents in the applicant's or tenant's file:

1. A written note to the file explaining why third-party verification is not possible; or

2. A copy of the date-stamped original request that was sent to the third party;

3. Written notes or documentation indicating follow-up efforts to reach the third party to obtain verification; and

4. A written note to the file indicating that the request has been outstanding without a response from the third party.

F. **Reasonable Accommodation**

If an applicant or tenant cannot read or sign a consent form because of a disability, the owner must provide a reasonable accommodation. See Chapter 2, Section 3, Subsection 4 for a description of the requirements regarding reasonable accommodations.

Examples – Reasonable Accommodation

- Provide forms in large print.
- Provide readers for persons with visual disabilities.
- Allow the use of a designated signatory.
- Visit the person's home if the applicant or tenant cannot travel to the office to complete the forms.

5-19 Confidentiality of Applicant and Tenant Information

A. Federal law limits the information owners can collect about an applicant or tenant to only information that is necessary to determine eligibility and level of assistance.

B. Federal privacy requirements also establish the responsibility of owners and their employees to use information provided by applicants and tenants only for specified program purposes and to prevent the use or disclosure of this information for other purposes.

1. To help ensure the privacy of applicant and tenant information, owners and their employees are subject to penalties for unauthorized disclosure

of applicant/tenant information. In addition, applicants and tenants may initiate civil action against an owner for unauthorized disclosure or improper use of the information they provided. Language on the HUD-required consent forms, the verification forms developed by owners, and the HUD-50059 clearly describes owners' responsibility regarding the privacy of this information and the possible penalties.

2. HUD encourages owners to develop their own procedures and internal controls to prevent the improper use or unauthorized disclosure of information about applicants and tenants. Adequate procedures and controls protect not only applicants and tenants, but also owners.

C. Owners must also comply with state privacy laws concerning the information they receive from third-party sources about applicants and tenants. These laws generally require confidentiality and restrict the uses of this information.

5-20 *Security of EIV Data

The data in EIV contains personal information on individual tenants that is covered by the Privacy Act. The information in EIV may only be used for limited official purposes.

A. Owners, in connection with the administration of their project, may only use the employment and income information in EIV at the time of recertification, or at other times as addressed in their policies and procedures.

B. Owners cannot share the EIV income information with governmental entities not involved in the recertification process used for HUD's assisted housing programs, e.g., the LIHTC program and RHS Section 515 program.

See Chapter 9, Enterprise Income Verification (EIV), for additional information on official use of EIV information.*

5-21 Refusal to Sign Consent Forms

A. If an applicant refuses to sign forms HUD-9887 or *HUD-9887-A* or the owner's verification forms, the owner must deny assistance.

B. If a tenant *or any member of the tenant's family* refuses to sign the required verification and consent forms, the owner must terminate *the household's* assistance. If the owner intends to terminate assistance for this reason, the owner must follow procedures established in the lease that require the tenant to pay the HUD-approved market rent for the unit. In a Section 202 PRAC or Section 811 PRAC project, the tenant may be evicted if the tenant *or any member of the tenant's family* refuses to sign the required verification and consent forms.

C. If a tenant is unable to sign the forms on time due to extenuating circumstances, the owner must document the reasons for the delay in the tenant file and indicate how and when the tenant will provide the proper signature.

Examples – Tenant Failure to Sign Consent Forms Due to Extenuating Circumstances

- Jonas and Joycelyn Hardwick were to have forms HUD-9887 and *HUD-9887-A* signed by their adult son. However, he was in an automobile accident and has been in a coma.
- Lydia Bailey's husband has been temporarily assigned to overseas duty as part of a missionary hunger-relief program. She has signed consent forms, and the forms have been mailed to him but have not been returned. She reports that mail has recently been taking five or six weeks.

5-22 Interim Recertifications

When processing an interim recertification, the owner must ask the tenant to identify all changes in income, expenses, or family composition since the last recertification. Owners only need verify those items that have changed. For example, if the head of household was laid off from his or her job and asks the owner to prepare an interim recertification, the owner does not need to reverify the spouse's employment income unless that has also changed. When the tenant signs the certification she or he certifies that the information on the report is accurate and current. Additional information about the procedures for conducting interim recertifications is discussed in Chapter 7, Section 2.

5-23 Record-Keeping Procedures

A. Owners must keep the following documents in the tenant's file at the project site:

1. All original, signed forms HUD-9887 and HUD-9887-A;

2. A copy of signed individual consent forms;

3. *A copy of the EIV Income Report, regardless of whether or not any income is reported for the household, along with the HUD-50059 and any other documentation obtained supporting income and rent determinations; and

4. Third-party verifications received from third-party sources.*

B. Owners must maintain documentation of all verification efforts throughout the term of each tenancy and for at least three years after the tenant moves out

C. The tenant's file should be available for review by the tenant upon request or by a third party who provides signed authorization for access from the tenant.

***NOTE:** The Federal Privacy Act (5 USC 552a, as amended) prohibits the disclosure of an individual's information to another person without the written

consent of such individual. As such, the EIV data of an adult household member may not be shared (or a copy provided or displayed) with another adult household member, unless the individual has provided written consent to disclose such information. See Chapter 9, paragraph 9-18 for more information on disclosing EIV data to another individual or entity.*

D. Owners must maintain applicant and tenant information in a way to ensure confidentiality. Any applicant or tenant affected by negligent disclosure or improper use of information may bring civil action for damages and seek other relief, as appropriate, against the employee. Forms HUD-9887 and *HUD-9887-A* describe the penalties for the improper use of consent forms.

E. Owners must dispose of tenant files and records in a manner that will prevent any unauthorized access to personal information, e.g., burn, pulverize, shred, etc.

Section 4: Calculating Tenant Rent

5-24 Key Regulations

This paragraph identifies key regulatory citations pertaining to Section 4: Calculating Tenant Rent. The citations and their titles or (topics) are listed below.

A. 24 CFR 5.628 Total Tenant Payment

B. 24 CFR 5.630 Minimum Rent

C. 24 CFR 236.735 Rental Assistance Payments and Rental Charges

D. 24 CFR 891.105, 891.410, 891.520, 891.640, 891.655, 891.705 (Project rental assistance payment, project assistance payment, tenant rent, total tenant payment, and rent for unassisted units)

E. 24 CFR 5.661 Section 8 project-based assistance programs: Approval for police or other security personnel to live in project

5-25 Calculating the Tenant Contribution for Section 8, PAC, PRAC, RAP, and Rent Supplement Properties

A. **Total Tenant Payment (TTP)**

The Total Tenant Payment (TTP) is the amount a tenant is expected to contribute for rent and utilities. TTP for Section 8, PAC, PRAC, RAP, and Rent Supplement properties is based on the family's income. The formulas for calculating TTP are shown in Figure 5-6. Exhibit 5-8 also shows the formulas for calculating tenant contributions for all assisted-housing programs.

B. **Unit Rent**

1. The contract rent (basic rent in the Section 236 program) represents the amount of rent an owner is entitled to collect to operate and maintain the property. It is HUD-approved. For Section 202 and 811 PRACS, the contract rent is the operating rent *(gross rent)* minus the utility allowance.

2. Projects in which the tenant pays all or some utilities have HUD-approved utility allowances that reflect an estimated average amount tenants will pay for utilities assuming normal consumption.

C. **Timeframe for Calculating Rent**

Owners calculate rent at three points in time.

1. Owners must calculate rent prior to occupancy by an applicant.

2. Owners must calculate rent as part of an annual recertification. Refer to Chapter 7, Section 1 for information on annual recertification of income.

3. When assistance is provided through Section 8, PAC, PRAC, RAP, or Rent Supplement, owners must recalculate rent if a tenant reports a change in income, allowances, or family composition. Refer to Chapter 7, Section 2 for information on interim recertifications of income.

Figure 5-6: Total Tenant Payment Formulas

Section 8, PAC, PRAC, and RAP

- TTP is the greater of the following:
  - 30% of monthly adjusted income;
  - 10% of monthly gross income;
  - Welfare rent (welfare recipients in as-paid localities only); or
  - The $25 minimum rent (Section 8 only).
- Section 8, RAP, and PAC programs may admit an applicant only if the TTP is less than the gross rent.
- In PRAC properties, the TTP may exceed the PRAC operating rent.

Rent Supplement

- TTP is the greater of the following:
  - 30% of monthly adjusted income; or
  - 30% of gross rent.
- At move-in or initial certification, the amount of Rent Supplement assistance may be no less than 10% of the gross rent or the tenant is not eligible.

5-26 Procedures for Determining Tenant Contribution for Section 8, PAC, PRAC, RAP, and Rent Supplement Properties

A. Tenant Rent

Tenant rent is the portion of the TTP the tenant pays each month to the owner for rent. Tenant rent is calculated by subtracting the utility allowance from the TTP.

It is possible for tenant rent to be $0 if the utility allowance is greater than the TTP.

Example – Calculating Tenant Rent

TTP:	$225
Utility allowance:	-$ 75
Tenant rent:	$150

B. **Assistance Payments**

The assistance payment is the amount the owner bills HUD every month on behalf of the tenant. The assistance payment covers the difference between the TTP and the gross rent. It is the subsidy that HUD pays to the owner.

1. Housing Assistance Payment (HAP) is the assistance payment made by HUD to owners with units receiving assistance from the Section 8 program.

Example – Calculating HAP

Gross rent	$564
TTP	- $175
HAP	$389

2. Rental Assistance Payment (RAP) is the assistance payment made by HUD to owners for units receiving assistance through the RAP program.

3. Rent Supplement payment is the assistance payment made by HUD to owners for units receiving assistance through the Rent Supplement program.

4. Project Assistance Payment (PAC) is the assistance payment made by HUD for assisted units in a Section 202 project for nonelderly disabled families and individuals (also referred to as Project Assistance Contract [PAC] projects).

5. Project Rental Assistance Payment (PRAC) is the assistance payment made by HUD for assisted units in Section 202 or Section 811 properties with a Project Rental Assistance Contract (PRAC).

C. **Utility Reimbursement**

When the TTP is less than the utility allowance, the tenant receives a utility reimbursement to assist in meeting utility costs. The tenant will pay no tenant rent. The utility reimbursement is calculated by subtracting the TTP from the utility allowance.

D. **Section 8 Minimum Rent**

Tenants in properties subsidized through the Section 8 program must pay a minimum TTP of $25.

NOTE: Minimum rent does not apply to Section 202 PAC, Section 202 PRAC, Section 811 PRAC, RAP, Rent Supplement, Section 221(d)(3) BMIR or Section 236 programs.

1. The minimum rent is used when 30% of adjusted monthly income and 10% of gross monthly income, and the welfare rent where applicable, are all below $25.

2. The minimum rent includes the tenant's contribution for rent and utilities. In any property in which the utility allowance is greater than $25, the full TTP is applied toward the utility allowance. The tenant will receive a utility reimbursement in the amount by which the utility allowance exceeds $25.

Example – Utility Reimbursement for a Tenant Paying Minimum Rent

The Nguyen family qualifies for the minimum total tenant payment of $25. The family pays its own utility bills. The utility allowance for the unit is $75 a month. The owner sends the Nguyen family a check each month for $50 ($75-$25) as a utility reimbursement. The Nguyen family does not pay any tenant rent to the owner.

3. Financial hardship exemptions.

   a. Owners must waive the minimum rent for any family unable to pay due to a long-term financial hardship, including the following:

      – The family has lost federal, state, or local government assistance or is waiting for an eligibility determination.

      – The family would be evicted if the minimum rent requirement was imposed.

      – The family income has decreased due to a change in circumstances, including but not limited to loss of employment.

      – A death in the family has occurred.

      – Other applicable situations, as determined by HUD, have occurred.

   b. Implementing an exemption request. When a tenant requests a financial hardship exemption, the owner must waive the minimum $25 rent charge beginning the month immediately following the tenant's request and implement the TTP calculated at the higher of 30% of adjusted monthly income or 10% of gross monthly income (or the welfare rent). The TTP will not drop to zero unless those calculations all result in zero.

(1) The owner may request reasonable documentation of the hardship in order to determine whether there is a hardship and whether it is temporary or long term in nature. The owner should make a determination within one week of receiving the documentation.

(2) If the owner determines there is no hardship as covered by the statute, the owner must immediately reinstate the minimum rent requirements. The tenant is responsible for paying any minimum rent that was not paid from the date rent was suspended. The owner may not evict the tenant for nonpayment of rent during the time in which the owner was making the determination. The owner and tenant should reach a reasonable repayment agreement for any back payment of rent.

(3) If the owner determines that the hardship is temporary, the owner may not impose the minimum rent requirement until 90 days after the date of the suspension. At the end of the 90-day period, the tenant is responsible for paying the minimum rent, retroactive to the initial date of the suspension. The owner may not evict the tenant for nonpayment of rent during the time in which the owner was making the determination or during the 90-day suspension period. The owner and tenant should reach a reasonable repayment agreement for any back payment of rent.

Example – Temporary Hardship Schedule

Due to the death of his wife, Yung Kim took a six-week leave of absence from his part-time job. He requests a financial hardship exception. The owner, Oak Knoll Management, reviews his request and determines that the hardship is not long term. Yung Kim and Oak Knoll Management implement the following schedule:

• Current TTP	$25
• Hardship request received	July 15
• Owner grants temporary hardship	July 20
• August TTP	$0
• September TTP	$0
• October TTP	$0
• 90-day period ends	October 15
Total balance due 3 x $25	$75
• Tenant agrees to pay $10 extra per month for seven months and $5 extra on the eighth month.	
• Monthly payment for seven months November May TTP $25 + $10	$35
• June TTP $25 + $5	$30
• July TTP	$25

(4) If the hardship is determined to be long term, the owner must exempt the tenant from the minimum rent requirement from the date the owner granted the suspension. The suspension may be effective until such time that the hardship no longer exists. However, the owner must recertify the tenant every 90 days while the suspension lasts to verify that circumstances have not changed. The length of the hardship exemption may vary from one family to another depending on the circumstances of each family. The owner must process an interim recertification to implement a long-term exemption. Owners must maintain documentation on all requests and determinations regarding hardship exemptions.

E. **Welfare Rent**

1. The term welfare rent applies only in states that have as-paid public benefit programs. A welfare program is considered as-paid if the welfare agency does the following:

   a. Designates a specific amount for shelter and utilities; and

b. Adjusts that amount based upon the actual amount the family pays for shelter and utilities.

2. The maximum amount that may be specifically designated for rent and utilities is called the welfare rent. See below for an example.

Example – Calculating Welfare Rent

Published maximum for shelter and utilities:	$200
Amount of welfare assistance for other needs:	$220
Other income:	$100

Monthly income =	$520
Welfare rent	$200

5-27 Calculating Assistance Payments for Authorized Police/Security Personnel

A. The amount of the monthly assistance payment to the owner is equal to the contract rent minus the monthly amount paid by the police officer or security personnel. HUD will not increase the assistance payment due to nonpayment of rent by the police officer or security personnel.

NOTE: The owner is not entitled to vacancy payments for the period following occupancy by a police officer or security personnel.

B. For police/security personnel whose income exceeds the income limit for the property, the rent is set by the owner.

1. The determination of the rent amount in such circumstances should take into consideration the income of the officer, the location of the property, and rents for comparable unassisted units in the area.

2. Owners should establish a rent that is attractive to the officer, but not less than what the officer would pay as an eligible Section 8 tenant.

3. Owners are expected to use a consistent methodology for each property when establishing the rents for officers in these circumstances.

5-28 Calculating Tenant Contribution for "Double Occupancy" in Group Homes

A. **Double Occupancy**

Some group homes for disabled residents provide units that may be shared by unrelated single tenants. The calculations for tenant contribution and for the assistance payment vary depending on whether the project is a Section 202/8 or a Section 811.

B. Total Tenant Payment

In both Section 202/8 and Section 811 group homes, each tenant in a double occupancy room is treated as a separate family in the calculation of TTP. Each resident is entitled to any deductions he or she would receive if occupying a single room, including the $400 elderly/disabled family deduction.

Example – TTP Calculation for Double Occupancy

Resident A:	
Annual income	$5,200
Elderly family deduction	- $400
Medical expense deduction	- $900
Annual adjusted income	$3,900
Monthly adjusted income	$325 ($3,900/12 months)
30% of monthly adjusted income	$98
10% of monthly gross income	$43
Minimum rent	$25
TTP for Resident A =	$98
Resident B:	
Annual income	$3,600
Elderly family deduction	- $400
Medical expense deduction	- $2,480
Annual adjusted income	$720
Monthly adjusted income	$60 ($720/12 months)
30% of monthly adjusted income	$18
10% of monthly gross income	$30
Minimum rent	$25
TTP for Resident B =	$30

C. Contract Rent and Assistance Payment in Section 202/8 Group Homes

1. In Section 202/8 group homes, the contract rent for a room shared by two occupants is split between the two tenants.

2. The assistance payment for the Section 202/8 double occupancy room is calculated separately for each tenant based on half of the contract rent for the unit.

Example – Assistance Payment, Section 202/8 Double Occupancy

Contract rent for the unit	$800
Half of the contract rent for the unit	$400
TTP for Tenant A =	$98
Assistance payment for Tenant A is $400 less $98 =	$302
TTP for Tenant B =	$30
Assistance payment for Tenant B is $400 less $30 =	$370

3. If the tenant rent for either tenant exceeds half of the contract rent, that tenant's rent will be capped at half of the contract rent. In the Section 202/8 double occupancy room, half of the contract rent is the maximum rent one occupant can pay.

Example – Section 202/8 Double Occupancy

Tenant A has an increase in income changing the monthly adjusted income to $1,500. 30% of $1,500 equals $450. Tenant A is no longer eligible for assistance. Tenant A's rent is capped at $400, which represents the maximum Tenant A will pay.

Gross rent for unit	$800
Half the contract rent for the unit	$400
TTP for Tenant A	$450
Assistance Payment for Tenant A	-0-
Rent Tenant A will pay	$400

4. Owner's rent-calculation software must reflect the split-unit rent and contain unit numbers that provide a distinction between tenants (e.g., unit 101A, 101B).

D. **Operating Cost and Assistance Payment in Section 811 Group Homes**

1. In a Section 811 group home, the operating cost for a room shared by two occupants is split between the two tenants.
2. The assistance payment for the Section 811 double occupancy room is calculated separately for each tenant based on half of the operating cost for the unit.

3. In a Section 811 property, each tenant is certified separately and pays the greater of 30% of monthly adjusted income, 10% of monthly annual income, or the welfare rent.

4. In the Section 811 double occupancy unit, both occupants will pay the calculated TTP amount even if it exceeds their portion of the operating cost for the unit.

Example – Calculating the Assistance Payment for a Double Occupancy Unit in a Section 811 Group Home

Operating cost for unit	$310
Half of the operating cost for the unit	$155
TTP Tenant A =	$160
Assistance Payment for Tenant A	$(5)
TTP Tenant B =	$75
Assistance Payment for Tenant B	$80

Although the Assistance Payment for Tenant A is zero, the voucher must indicate that $5 over the operating cost was collected for rent. This is indicated by bracketing the ($5.)

5. Owner's rent-calculation software must reflect the split-unit operating cost and contain unit numbers that provide a distinction between tenants (e.g., unit 101A, 101B).

Example – Section 811 Total Tenant Payments

Operating cost for the unit	$310
One half of operating cost	$155
TTP Tenant A =	$330
Assistance Payment for Tenant A	($175)
TTP Tenant B =	$240
Assistance payment for Tenant B	($85)

E. **Calculating Rent at Change in Occupancy**

1. If there is a change in the number of individuals occupying the double occupancy unit, the assistance payment for the whole unit may change.

2. In a Section 202/8 or a Section 811 PRAC double-occupancy room, the rent and assistance payments are calculated as if each tenant occupied a separate unit each with a rent equaling half of the contract rent or operating cost for the unit. If one resident moves out, the TTP and assistance payment calculations for the remaining resident remain the same. The other half of the unit is treated like a vacant unit: there is no assistance payment but the owner may be eligible for vacancy loss claims for the vacated half of the unit.

Example – Section 202/8 Calculation at a Change in Occupancy

Contract Rent	$800
Half of the contract rent	$400
Tenant A Tenant Rent	$98
Tenant B Tenant Rent	$30

Tenant A moves out.

Assistance Payment for Tenant B is calculated using half of the contract rent = $400 less the Tenant Rent for Tenant B $30 = $370 housing assistance payment.

There is no HAP payment for the half of the unit vacated by Tenant A. It is vacant. But, the owner may request a vacancy loss payment if appropriate.

Example – Section 811 Calculation at a Change in Occupancy

Operating Cost	$310
Half of the operating cost	$155
Tenant A Tenant Rent	$160
Tenant B Tenant Rent	$75

Tenant A moves out.

Assistance Payment for Tenant B is calculated using half of the operating cost = $155 less the Tenant Rent for Tenant B $75 = $80 housing assistance payment.

There is no Assistance Payment for the half of the unit vacated by Tenant A. It is vacant. Even though Tenant A was paying more than half of the operating cost for the unit at move-out, the owner may request a vacancy loss payment if all other vacancy claim requirements have been met.

5-29 Calculating Tenant Contribution for Section 236 and Section 221(d)(3) Below Market Interest Rate (BMIR)

A. Tenant's Rent Contribution

The tenant's contribution to rent in the Section 236 and Section 221(d)(3) BMIR programs is based on the cost to operate the property and the income of the family. Figure 5-7 presents the rules for determining the tenant rent in these two programs.

1. Section 236 property. Every Section 236 property has a HUD-approved basic rent and market rent. Basic rent is the minimum rent all Section 236 tenants must pay. It represents the cost to operate the property after HUD has provided mortgage assistance to reduce the mortgage interest expense. The market rent represents the amount of rent the owner would have to charge, if the mortgage were not subsidized. Tenants pay a percentage of their income towards rent, but never pay less than the basic rent or more than the market rent for the property.

   When a tenant pays more than basic rent, the difference between the tenant's rent and basic rent is called excess income. Excess income is an amount that exceeds what the owner needs to operate the property and is subject to specific requirements. Refer to HUD Handbook 4350.1, *Multifamily Asset Management and Project Servicing*, and other current HUD notices for guidance on handling excess income. Although a tenant may pay more than basic rent, no tenant in a Section 236 property will pay more than the market rent for the property.

Example – Calculating Excess Income

Rent for Tenant A (30 of Tenant A's income):	$350
Basic rent	-$300
Excess Income	$50

2. Section 221(d)(3) BMIR property. There is no rent calculation for tenants in a Section 221(d)(3) BMIR property. HUD approves a BMIR rent that all of the tenants must pay. The federal assistance in the BMIR property is provided through a below market interest rate for the mortgage loan. Applicants must meet income eligibility standards to be admitted to a BMIR property. After move-in, if a tenant's annual income goes above 110% of the BMIR income limit, the tenant must pay 110% the BMIR rent.

3. BMIR cooperative. If a BMIR cooperative member's annual income exceeds 110% of the BMIR income limit at the time of recertification, the cooperative must levy a surcharge to the member. See the definition of market rent in the Glossary for an explanation of the market carrying charge for over-income cooperative members.

B. Timeframe for Calculating Rent

Owners calculate rent at three points in time.

1. Owners must calculate rent prior to occupancy by an applicant.

2. Owners must calculate rent as part of an annual recertification. Refer to Chapter 7, Section 1 for information on annual recertification of income.

3. Owners of Section 236 properties must calculate rent if a tenant reports a change in income, allowances, or family composition. Refer to Chapter 7, Section 2 for information on interim recertifications of income.

Figure 5-7: Tenant Contributions for the Section 236 and Section 221(d)(3) BMIR

Section 236

Section 236 without Utility Allowance

- Tenant rent is the greater of:
  - 30% of monthly adjusted income; or
  - Section 236 basic rent.
- Tenant rent may not be more than the Section 236 market rent.

Section 236 with Utility Allowance

- Tenant rent is the greater of:
  - 30% of monthly adjusted income less the utility allowance; or
  - 25% of monthly adjusted income; or
  - Basic rent.
- Tenant rent may not be more than the Section 236 market rent.

Section 221(d)(3) BMIR

- At initial certification, the tenant pays the BMIR rent.
- At recertification, the tenant's annual income is compared to the BMIR income limits. If the tenant's annual income is:
  - Less than or equal to 110% of the BMIR income limit, the tenant pays the BMIR rent;
  - Greater than 110% of the BMIR income limit, the tenant pays 110% of the BMIR rent.

5-30 Determining Tenant Contribution at Properties with Multiple Forms of Subsidy

A. At many multifamily properties different kinds of subsidies have been combined. For many years, tenant-based Section 8 subsidies have been added to properties built with Section 202 loans or financed with Section 236 and Section 221(d)(3) mortgage subsidies. Recently, the Low Income Housing Tax Credit program has been combined with a wide range of programs, from Section 202 projects with Section 8 already in place (Section 202/8) to housing choice voucher assistance.

B. Although each of the programs combined within one property may have a different formula for determining tenant payments, it is generally possible to determine the correct rent for a family by identifying the available program for which that family is eligible that will provide the best option—or the lowest rent—for the tenant. The one exception to this can be at the recertification of a Section 8 or Rent Supplement family in a property with Low Income Housing Tax Credits. If the family's income has increased since move-in to a point that the assisted rent exceeds the Low Income Housing Tax Credit rent, that family will have to make a choice between the lower tax credit rent and the security of continuing on the rental assistance program.

C. The tenant rent at properties assisted under more than one program is generally the lowest rent available for which the tenant is eligible.

1. Section 202/Section 8. In a Section 202 property with Section 8 tenant-based assistance, a tenant eligible for Section 8 will pay the tenant rent based on the Section 8 rent formula. If that tenant's income increases to the point that its TTP equals or exceeds the Section 8 contract rent, the family would no longer be eligible for the tenant based assistance.

2. Section 236/Section 8. A family with a Section 8 subsidy in a Section 236 property will pay the Section 8 tenant rent unless, at recertification, the family's TTP equals or exceeds the Section 8 contract rent. Thereafter, the family will pay the tenant rent based on the Section 236 rent formula. A family living in a Section 236 property receiving Rent Supplement assistance would also stop receiving Rent Supplement assistance at the point the family's TTP increased to the level of the rent supplement contract rent. Thereafter the family will pay the tenant rent based on the Section 236 rent formula.

3. Section 221(d)(3) BMIR with Section 8. A family receiving Section 8 assistance at a BMIR project would continue to pay the tenant rent based on the Section 8 rent formula until the TTP equaled or exceeded the BMIR rent. Thereafter, the family would pay rent based on the BMIR rent formula.

D. In some instances, a tenant will not be eligible for the program offering the lowest rent, or a subsidy under that program will not be available for every unit or every tenant.

Sometimes, Section 8 subsidies are not available for the unit size the family needs, and the family must wait for a subsidy for the appropriate unit size. The owner's contract with HUD for the Section 8 assistance allocates Section 8 funding by unit size, and the owner is required to subsidize families based on the unit sizes allocated. If the owner was allocated 10 two-bedroom subsidies and has assigned those subsidies to 10 two-bedroom families, the owner cannot use an available three-bedroom subsidy to assist an 11th two-bedroom family. If the owner has determined that the bedroom distribution in its contract does not match the need in the project, the owner can ask HUD for a contract amendment to revise the unit size designations of the subsidy awarded.

E. In some instances, a family will not be eligible for a lower rent program available at the property.

For example, a family in a BMIR project with Section 8 may be financially stretched when paying the BMIR rent but may not be income-eligible for the lower-rent Section 8 program.

5-31 Procedures for Calculating Rent

A. Owners must calculate tenant rent payments electronically using on-site software or a service provider. Data used to determine the rent are based on information certified as accurate by the family and independently verified.

B. The owner's computer software calculates rent based on the appropriate formulas for the tenant's unit and produces a printed copy of the HUD-50059 to be signed by the tenant and the owner. The owner must produce a printed report in an easily read and understood format that contains all of the information used to calculate the tenant's rent.

C. The tenant and the owner sign a copy of the report containing a statement certifying the accuracy of the information. The certification statements are provided on the form HUD-50059 in Appendix 7-B.

D. The owner must give a copy of the printed HUD-50059 with the required signatures to the tenant and place another copy in the tenant file.

E. The HUD-50059 is then transmitted electronically to TRACS either directly or through the Contract Administrator.

F. In all cases, the computer generated HUD-50059 must include the required tenant signatures and owner signatures prior to submitting the data to the Contract Administrator or HUD. The owner may consider extenuating circumstances when an adult family member is not available to sign the HUD-50059, for example, an adult serving in the military, students away at college, adults who are hospitalized for an extended period of time, or a family member who is permanently confined to a nursing home or hospital. The owner must document the file why the signature(s) was not obtained and, if applicable, when the signature(s) will be obtained.

Chapter 5 Exhibits

5-1. Income Inclusions and Exclusions

http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_35699.pdf

5-2. Assets

http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_35701.pdf

5-3. Examples of Medical Expenses That Are Deductible and Nondeductible

http://portal.hud.gov/hudportal/documents/huddoc?id=43503e5-3HSGH.pdf

5-4. Sample Certification for Qualified Long-Term Care Insurance Expenses

http://portal.hud.gov/hudportal/documents/huddoc?id=90101.pdf

5-5. Form HUD-9887, *Notice and Consent for the Release of Information to HUD and to a PHA*

http://portal.hud.gov/hudportal/documents/huddoc?id=9887.pdf

5-6. Form HUD-9887-A, *Applicant's/Tenant*'s *Consent to the Release of Information – Verification by Owners of Information Supplied by Individuals Who Apply for Housing Assistance*

See 5-5 above.

5-7. HUD Fact Sheet Verification of Information Provided by Applicants and Tenants of Assisted Housing

See 5-5 above.

5-8. Tenant Rent Formulas

http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_35705.pdf

Exhibit 5-1: Income Inclusions and Exclusions

24 CFR 5.609(b) and (c)

Examples included in parentheses have been added to the regulatory language for clarification.

INCOME INCLUSIONS

(1) The full amount, before any payroll deductions, of wages and salaries, overtime pay, commissions, fees, tips and bonuses, and other compensation for personal services;

(2) The net income from operation of a business or profession. Expenditures for business expansion or amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation of assets used in a business or profession may be deducted, based on straight line depreciation, as provided in Internal Revenue Service regulations. Any withdrawal of cash or assets from the operation of a business or profession will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested in the operation by the family;

(3) Interest, dividends, and other net income of any kind from real or personal property. Expenditures for amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation is permitted only as authorized in paragraph (2) above. Any withdrawal of cash or assets from an investment will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested by the family. Where the family has net family assets in excess of $5,000, annual income shall include the greater of the actual income derived from all net family assets or a percentage of the value of such assets based on the current passbook savings rate, as determined by HUD;

(4) The full amount of periodic amounts received from social security, annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts, including a lump-sum amount or prospective monthly amounts for the delayed start of a **periodic amount (e.g., Black Lung Sick benefits, Veterans Disability, Dependent Indemnity Compensation, payments to the widow of a serviceman killed in action). See paragraph (13) under Income Exclusions for an exception to this paragraph;**

(5) Payments in lieu of earnings, such as unemployment, disability compensation, worker's compensation, and severance pay, except as provided in paragraph (3) under Income Exclusions;

(6) Welfare Assistance.

(a) Welfare assistance received by the family.

(b) If the welfare assistance payment includes an amount specifically designated for shelter and utilities that is subject to adjustment by the welfare assistance agency in accordance with the actual cost of shelter and utilities, the amount of welfare assistance income to be included as

income shall consist of:

(c) The amount of the allowance or grant exclusive of the amount specifically designated for shelter or utilities; plus

(d) The maximum amount that the welfare assistance agency could in fact allow the family for shelter and utilities. If the family's welfare assistance is ratably reduced from the standard of need by applying a percentage, the amount calculated under this paragraph shall be the amount resulting from one application of the percentage.

(7) Periodic and determinable allowances, such as alimony and child support payments, and regularr contributions or gifts received from organizations or from persons not residing in the dwelling; and

(8) All regular pay, special pay, and allowances of a member of the Armed Forces, except as provided in paragraph (7) under Income Exclusions.

(9) For Section 8 programs only and as provided in 24 CFR 5.612, any financial assistance, in excess of amounts received for tuition, that an individual receives under the Higher Education Act of 1965 (20 U.S.C. 1001 *et seq.)*, from private sources, or from an institution of higher education (as defined under the Higher Education Act of 1965 (20 U.S.C. 1002)), shall be considered income to that individual, except that financial assistance described in this paragraph is not considered annual income for persons over the age of 23 with dependent children. For purposes of this paragraph "financial assistance" does not include loan proceeds for the purpose of determining income. *(Note: This paragraph also does not apply to a student who is living with his/her parents who are applying for or receiving Section 8 assistance.)*

INCOME EXLCUSIONS:

(1) Income from employment of children (including foster children) under the age of 18 years;

(2) Payments received for the care of foster children or foster adults (usually persons with disabilities unrelated to the tenant family, who are unable to live alone);

(3) Lump-sum additions to family assets, such as inheritances, insurance payments (including payments under health and accident insurance and worker's compensation), capital gains, and settlement for personal or property losses, except as provided in paragraph (5) under Income Inclusions;

(4) Amounts received by the family that are specifically for, or in reimbursement of, the cost of medical expenses for any family member;

(5) Income of a live-in aide, as defined in 24 CFR 5.403;

(6) The full amount of student financial assistance paid directly to the student or to the educational institution (see Income Inclusions (9), above, for students receiving Section 8 assistance);

(7) The special pay to a family member serving in the Armed Forces who is exposed to hostile fire (e.g., in the past, special pay included Operation Desert Storm);

(8) (a) Amounts received under training programs funded by HUD (e.g., training received under Section 3);

(b) Amounts received by a person with a disability that are disregarded for a limited time for purposes of supplemental security income eligibility and benefits because they are set-aside for use under a Plan to Attain Self-Sufficiency (PASS);

(c) Amounts received by a participant in other publicly assisted programs that are specifically for or in reimbursement of out-of-pocket expenses incurred (special equipment, clothing, transportation, child care, etc.) and which are made solely to allow participation in a specific program;

(d) Amounts received under a resident service stipend. A resident service stipend is a modest amount (not to exceed $200 per month) received by a resident for performing a service for the owner, on a part-time basis, that enhances the quality of life in the project. Such services may include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, and resident-initiative coordination. No resident may receive more than one such stipend during the same period of time; or

(e) Incremental earnings and benefits resulting to any family member from participation in qualifying state or local employment training programs (including training programs not affiliated with a local government) and training of a family member as a resident management staff person. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for the period during which the family member participates in the employment training program.

(9) Temporary, nonrecurring, or sporadic income (including gifts);

(10) Reparation payments paid by a foreign government pursuant to claims filed under the laws of that government by persons who were persecuted during the Nazi era. (Examples include payments by the German and Japanese governments for atrocities committed during the Nazi era);

(11) Earnings in excess of $480 for each full-time student 18 years or older (excluding the head of household and spouse);

(12) Adoption assistance payments in excess of $480 per adopted child;

(13) Deferred periodic amounts from supplemental security income and social security benefits that are received in a lump-sum amount or in prospective monthly amounts;

(14) Amounts received by the family in the form of refunds or rebates under state or local law for property taxes paid on the dwelling unit;

(15) Amounts paid by a state agency to a family with a member who has a developmental disability and is living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member at home; or

(16) Amounts specifically excluded by any other federal statute from consideration as income for purposes of determining eligibility or benefits under a category of assistance programs that includes assistance under any program to which the exclusions set forth in 24 CFR 5.609(c) apply. A notice will be published in the *Federal Register* and distributed to housing owners identifying the benefits that qualify for this exclusion. Updates will be published and distributed when necessary.

The following is a list of income sources that qualify for that exclusion:

(a) The value of the allotment provided to an eligible household under the Food Stamp Act of 1977 (7 U.S.C. 2017 [b]);

(b) Payments to Volunteers under the Domestic Volunteer Services Act of 1973 (42 U.S.C. 5044(g), 5058) (employment through AmeriCorps, Volunteers in Service to America [VISTA], Retired Senior Volunteer Program, Foster Grandparents Program, youthful offender incarceration alternatives, senior companions);

(c) Payments received under the Alaska Native Claims Settlement Act (43 U.S.C. 1626[c])

(d) Income derived from certain submarginal land of the United States that is held in trust for certain Indian tribes (25 U.S.C. 459e);

(e) Payments or allowances made under the Department of Health and Human Services' Low-Income Home Energy Assistance Program (42 U.S.C. 8624[f]);

(f) Payments received under programs funded in whole or in part under the Job Training Partnership Act (29 U.S.C. 1552[b]; (effective July 1, 2000, references to Job Training Partnership Act shall be deemed to refer to the corresponding provision of the Workforce Investment Act of 1998 [29 U.S.C. 2931], e.g., employment and training programs for Native Americans and migrant and seasonal farm workers, Job Corps, veterans employment programs, state job training programs, career intern programs, Americorps);

(g) Income derived from the disposition of funds to the Grand River Band of Ottawa Indians (Pub. L-94-540, 90 Stat. 2503-04);

(h) The first $2,000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the U. S. Claims Court and the interests of individual Indians in trust or restricted lands, including the first $2,000 per year of income received by individual Indians from funds derived from interests held in such trust or restricted lands (25 U.S.C. 1407-1408);

(i) Amounts of scholarships funded under title IV of the Higher Education Act of 1965, including awards under federal work-study programs or under the Bureau of Indian Affairs student assistance programs (20 U.S.C. 1087uu);

(j) Payments received from programs funded under Title V of the Older Americans Act of 1985 (42 U.S.C. 3056[f]), e.g., Green Thumb, Senior Aides, Older American Community Service Employment Program;

(k) Payments received on or after January 1, 1989, from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in *In Re Agent*-product liability litigation, M.D.L. No. 381 (E.D.N.Y.);

(l) Payments received under the Maine Indian Claims Settlement Act of 1980 (25 U.S.C. 1721);

(m) The value of any child care provided or arranged (or any amount received as payment for such care or reimbursement for costs incurred for such care) under the Child Care and Development Block Grant Act of 1990 (42 U.S.C. 9858q);

(n) Earned income tax credit (EITC) refund payments received on or after January 1, 1991, including advanced earned income credit payments (26 U.S.C. 32[j]);

(o) Payments by the Indian Claims Commission to the Confederated Tribes and Bands of Yakima Indian Nation or the Apache Tribe of Mescalero Reservation (Pub. L. 95-433);

(p) Allowances, earnings, and payments to AmeriCorps participants under the National and Community Service Act of 1990 (42 U.S.C. 12637[d]);

(q) Any allowance paid under the provisions of 38 U.S.C. 1805 to a child suffering from spina bifida who is the child of a Vietnam veteran (38 U.S.C. 1805);

(r) Any amount of crime victim compensation (under the Victims of Crime Act) received through crime victim assistance (or payment or reimbursement of the cost of such assistance) as determined under the Victims of Crime Act because of the commission of a crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602); and

(s) Allowances, earnings and payments to individuals participating in programs under the Workforce Investment Act of 1998 (29 U.S.C. 2931).

Exhibit 5-2: Assets

NOTE: There is no asset limitation for participation in HUD assisted-housing programs. However, the definition of annual income includes net income from family assets.

A. Net Family Assets include the following:

1. Cash held in savings and checking accounts, safe deposit boxes, homes, etc. For savings accounts, use the current balance. For checking accounts, use the average balance for the last six months. Assets held in foreign countries are considered assets.

2. Revocable trusts. Include the cash value of any revocable trust available to the family. See discussion of trusts in paragraph 5-7 G.1.

3. Equity in rental property or other capital investments. Include the current fair market value less (a) any unpaid balance on any loans secured by the property and (b) reasonable costs that would be incurred in selling the asset (e.g., penalties, broker fees, etc.).

   NOTE: If the person's main business is real estate, then count any income as business income under paragraph 5-6 G of the chapter. Do not count it both as an asset and business income.

4. Stocks, bonds, Treasury bills, certificates of deposit, mutual funds, and money market accounts. Interest or dividends earned are counted as income from assets even when the earnings are reinvested. The value of stocks and other assets vary from one day to another. The value of the asset may go up or down the day before or after rent is calculated and multiple times during the year thereafter. The owner may assess the value of these assets at any time after the authorization for the release of information has been received. The tenant may request an interim recertification at any time thereafter that a decrease in stock value may result in a decrease in rent.

5. Individual retirement, 401K, and Keogh accounts. These are included when the holder has access to the funds, even though a penalty may be assessed. If the individual is making occasional withdrawals from the account, determine the amount of the asset by using the average balance for the previous six months. (Do not count withdrawals as income.)

Example – Withdrawals from a Keogh Account

Ly Pham has a Keogh account valued at $30,000. When she turns 70 years old, she begins drawing $2,000 a year. Continue to count the account as an asset. Use the guidance in paragraph 5-7 to determine the cash value and imputed income from the asset. Do not count the $2,000 she withdraws as income.

6. Retirement and pension funds.

a. While the person is employed. Include only amounts the family can withdraw without retiring or terminating employment. Count the whole amount less any penalties or transaction costs. Follow paragraph 5-7 G.4 of the chapter on determining the value of assets.

b. At retirement, termination of employment, or withdrawal. Periodic receipts from pension and retirement funds are counted as income. Lump-sum receipts from pension and retirement funds are counted as assets. Count the amount as an asset or as income, as provided below.

(1) If benefits will be received in a lump sum, include the lump-sum receipt in net family assets.

(2) If benefits will be received through periodic payments, include the benefits in annual income. Do not count any remaining amounts in the account as an asset.

(3) If the individual initially receives a lump-sum benefit followed by periodic payments, count the lump-sum benefit as an asset as provided in the example below and treat the periodic payment as income. In subsequent years, count only the periodic payment as income. Do not count the remaining amount as an asset.

NOTE: This paragraph and the example below assume that the lump-sum receipt is a one-time receipt and that it does not represent delayed periodic payments. However, in situations in which a lump-sum payment does represent delayed periodic payments, then the amount would be considered as income and not an asset.

Example – Retirement Benefits as Lump-Sum and Periodic Payments

Upon retirement, Eleanor Reilly received a lump-sum payment of $15,000. She will also receive periodic pension payments of $350 a month.

The lump-sum amount of $15,000 is generally treated as an asset. In this instance, however, Eleanor spent $5,000 of the lump sum on a trip following her retirement. The remaining $10,000 she placed in her mutual fund with other savings. The entire mutual fund will be counted as an asset.

The owner has verified that Eleanor is now not able to withdraw the balance from her pension. Therefore, the owner will count the $350 monthly pension payment as annual income and will not list the pension account as an asset.

7. Cash value of life insurance policies available to the individual before death (e.g., the surrender value of a whole life policy or a universal life policy). It would not include a value for term insurance, which has no cash value to the individual before death.

8. Personal property held as an investment. Include gems, jewelry, coin collections, or antique cars held as an investment. Personal jewelry is NOT considered an asset.

9. Lump-sum receipts or one-time receipts. (See paragraph 5-6 **P** for additional information on what is counted as a lump-sum receipt and how to treat lump-sum receipts.) These include inheritances, capital gains, one-time lottery winnings, victim's restitution, settlements on insurance claims (including health and accident insurance, worker's compensation, and personal or property losses), and any other amounts that are not intended as periodic payments.

10. A mortgage or deed of trust held by an applicant.

    a. Payments on this type of asset are often received as one combined payment of principal and interest with the interest portion counted as income from the asset.

    b. This combined figure needs to be separated into the principal and interest portions of the payment. (This can be done by referring to an amortization schedule that relates to the specific term and interest rate of the mortgage.)

    c. To count the actual income for this asset, use the interest portion due, based on the amortization schedule, for the 12-month period following the certification.

    d. To count the imputed income for this asset, determine the asset value **as of the effective date of the certification**. Since this amount will continually be reduced by the principal portion paid during the previous year, the owner will have to determine this amount at each annual recertification. See the following example:

Example – Deed of Trust and Imputed Income

Computation of imputed income:
An elderly tenant sells her home and holds the mortgage for the buyer. The cash value of the mortgage is $60,000. The combined payment of principal and interest expected to be received for the upcoming year is $5,000. The amortization schedule breaks that payment into $2,000 in principal and $3,000 in interest. In completing the asset income calculation, the cash value of the asset is $60,000, and the projected annual income from that asset is $3,000. **The imputed income would be calculated by multiplying the cash value of $60,000 by the 2% imputed passbook rate.** Each subsequent year, the cash value of the asset should be reduced by the principal portion paid. In this example, it would be reduced to $58,000 in the following year ($60,000 – $2,000 principal payment = $58,000). **When calculating the imputed income for the following year, the owner would multiply the cash value of $58,000 by the 2% passbook savings rate.**

Regulatory References

(These references are current as of the date of publication. Readers should refer to the latest edition of the Code of Federal Regulations.)

24 CFR part 5.603 defines net family assets as follows:

Net cash value after deducting reasonable costs that would be incurred in disposing of real property, savings, stocks, bonds, and other forms of capital investment, excluding interests in Indian trust land and the equity accounts in HUD homeownership programs. The value of necessary items of personal property such as furniture and automobiles shall be excluded. . . . . In determining net family assets, owners shall include the value of any business or family assets disposed of by an applicant or tenant for less than fair market value (including a disposition in trust, but not in a foreclosure or bankruptcy sale) during the two years preceding the date of application for the program or recertification, as applicable, in excess of the consideration received therefor. In the case of a disposition as part of a separation or divorce settlement, the disposition will not be considered to be for less than fair market value if the applicant or tenant receives important consideration not measurable in dollar terms.

B. Net family assets **DO NOT** include the following:

IMPORTANT: The owner does not compute income from any assets in this paragraph.

1. Personal property (clothing, furniture, cars, wedding ring, other jewelry that is not held as an investment, vehicles specially equipped for persons with disabilities).

2. Interests in Indian trust land.

3. Term life insurance policies (i.e., where there is no cash value).

4. Equity in the cooperative unit in which the family lives.

5. Assets that are part of an active business. "Business" does NOT include rental of properties that are held as investments unless such properties are the applicant's or tenant's main occupation.

Example – Assets that are Part of an Active Business

- Laura and Lester Hines own a copier and courier service. None of the equipment that they use in their business is counted as an asset (e.g., the copiers, the FAX machines, the bicycles).
- Alice Washington rents out the home that she and her husband lived in for 42 years. This home is not an active business asset. Therefore, it is considered an asset and the owner must determine the annual income that Alice receives from it.

6. Assets that are NOT effectively owned by the applicant. Assets are not effectively owned when they are held in an individual's name, but (a) the assets and any income they earn accrue to the benefit of someone else who is not a member of the family, and (b) that other person is responsible for income taxes incurred on income generated by the assets.

   NOTE: Nonrevocable trusts (i.e., irrevocable trusts) are not covered by this paragraph. See information on nonrevocable trusts in paragraph 5-7 G.1.

Example – Assets not Effectively Owned by the Applicant

Net family assets do not include assets held pursuant to a power of attorney because one party is not competent to manage the assets, or assets held in a joint account solely to facilitate access to assets in the event of an emergency.

Example: Alexander Cumbow and his daughter, Emily Bornscheuer, have a bank account with both names on the account. Emily's name is on that account for the convenience of her father in case an emergency arises that would result in Emily handling payments for her father. Emily has not contributed to this asset, does not receive interest income from it, nor does she pay taxes on the interest earned. Therefore, Emily does not own this account. If Emily applies for assisted housing, the owner should not count this account as her asset. This asset belongs to Alexander and would be counted entirely as the father's asset should he apply for assisted housing.

7. Assets that are not accessible to the applicant and provide no income to the applicant. Nonrevocable trusts are not covered under this paragraph. See information on nonrevocable trusts in paragraph 5-7 G.1.

Example

A battered spouse owns a house with her husband. Because of the domestic situation, she receives no income from the asset and cannot convert the asset to cash.

Exhibit 5-3: Examples of Medical Expenses That Are Deductible and Nondeductible

The following are examples of eligible items for medical expense deductions. Please note that this list is not exhaustive.

Type of Medical Expenses	May Include*
Services of recognized health care professionals	Services of physicians, nurses, dentists, opticians, mental health practitioners, osteopaths, chiropractors, Christian Science practitioners, and acupuncture practitioners
Services of health care facilities; laboratory fees, X-rays and diagnostic tests, blood, oxygen	Hospitals, health maintenance organizations (HMOs), laser eye surgery, out-patient medical facilities, and clinics
Alcoholism and drug addiction treatment	
Medical insurance premiums	Expenses paid to an HMO; Medicaid insurance payments that have not been reimbursed; long-term care premiums (not prorated)
Prescription and nonprescription medicines	Aspirin, antihistamine only if prescribed by a physician for a particular medical condition
Transportation to/from treatment and lodging	Actual cost (e.g., bus fare) or, if driving in a car, a mileage rate based on IRS rules. *If the individual is receiving reimbursement for the cost of transportation to/from treatment or the lodging from another source, the cost or mileage is not eligible for the medical expense deduction*.
Medical care of permanently institutionalized family member IF his/her income is included in Annual Income	
Dental treatment	Fees paid to the dentist; x-rays; fillings, braces, extractions, dentures
Eyeglasses, contact lenses	
Hearing aid and batteries, wheelchair, walker, artificial limbs, Braille books and magazines, oxygen and oxygen equipment	Purchase and upkeep (e.g., additional utility costs to tenant because of oxygen machine [in properties with tenant paid utilities only])
Attendant care or periodic medical care	Nursing services, assistance animal and its upkeep
Payments on accumulated medical bills	Scheduled payments

* Or any other medically necessary service, apparatus, or medication, as documented by third-party verification.

Some items that **may not** be included in medical expense deductions are listed below.

Medical Expenses	May Not Include
Cosmetic surgery	Do not include in medical expenses amounts paid for unnecessary cosmetic surgery. This applies to any procedure that is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease. Procedures such as face-lifts, hair transplants, hair removal (electrolysis), and liposuction generally are not deductible. However, if medical complications, e.g., infections, etc., occur as a result of the procedure that requires medical treatment, the medical treatment expenses would be treated as a medical expense deduction. Amounts paid for cosmetic surgery may be deducted if necessary to improve a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease.
Health club dues	Do not include in medical expenses the cost of membership in any club organized for business, pleasure, recreation, or other social purpose, such as health club dues, YMCA dues, or amounts paid for steam baths for general health or to relieve physical or mental discomfort not related to a particular medical condition.
Household help	Do not include in medical expenses the cost of household help, even if such help is recommended by a doctor. However, certain expenses paid to a person providing nursing-type services may be deductible as medical costs.
Medical savings account (MSA)	Do not deduct as a qualified medical expense amounts contributed to an Archer MSA.
Nutritional supplements, vitamins, herbal supplements, natural medicines	Do not include in medical expenses the cost of nutritional supplements, vitamins, herbal supplements, natural medicines, etc., unless they are recommended in writing by a medical practitioner licensed in the locality where practicing. These items must be recommended as treatment for a specific medical condition diagnosed by a physician or other health care provider licensed to make a diagnosis in the locality where practicing. Otherwise, these items are taken to maintain ordinary good health, and are not for medical care.

Medical Expenses	May Not Include
Personal use items	Do not include in medical expenses an item ordinarily used for personal, living, or family purposes unless it is used primarily to prevent or alleviate a physical or mental defect or illness. For example, the cost of a wig purchased upon the advice of a physician for the mental health of a patient who has lost all of his or her hair from disease or incontinence supplies can be included with medical expenses
Nonprescription medicines	Do not include in medical expenses nonprescription medicines unless they are recommended in writing by a medical practitioner licensed in the locality where practicing. These items must be recommended as treatment for a specific medical condition diagnosed by a physician or other health care provider licensed to make a diagnosis in the locality where practicing.

Exhibit 5-4: Certification for Qualified Long-Term Care Insurance Expenses

I certify that the long-term care insurance policy for which I pay premiums,

(insert policy provider name) _____,

policy number _____ meets the following conditions.

1. It is guaranteed renewable;

2. It does not provide a cash surrender value which can be paid, assigned, pledged, or borrowed;

3. It provides that refunds (other than refunds on the death of the insured or complete surrender or cancellation of the contract) and dividends under the contract may be used only to reduce future premiums or increase future benefits; and,

4. It does not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare (except where Medicare is a secondary payer or the contract makes per diem or other periodic payments without regard to expenses).

_____
Name (print)

_____
Name (sign)

_____
Unit Number

Public reporting burden for this collection is estimated to average 10 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. This information is required to obtain benefits and is voluntary. HUD may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number. Upon completion of the certification, the insurance premiums are then included in the tenant's total medical expenses deduction which is electronically transmitted by the owner/management agent to HUD's Tenant Rental Assistance Certification System (TRACS).

This information is authorized by the 24 CFR 5.611(a)(3)(i) which allows for unreimbursed medical expenses in excess of three (3) percent of annual income be included as a mandatory deduction from annual income for any elderly family or disabled family in order to arrive at the adjusted income used for rent and subsidy determination. This information is considered non-sensitive and does no require any special protection.

U.S. Department of Housing and Urban Development

Document Package for Applicant's/Tenant's Consent to the Release Of Information

This Package contains the following documents:

1. **HUD-9887/A Fact Sheet describing the necessary verifications**
2. **Form HUD-9887 (to be signed by the Applicant or Tenant)**
3. **Form HUD-9887-A (to be signed by the Applicant or Tenant and Housing Owner)**
4. **Relevant Verifications (to be signed by the Applicant or Tenant)**

Each household must receive a copy of the 9887/A Fact Sheet, form HUD-9887, and form HUD-9887-A.

Verification of Information Provided by Applicants and Tenants of Assisted Housing

What Verification Involves

To receive housing assistance, applicants and tenants who are at least 18 years of age and each family head, spouse, or co-head regardless of age must provide the owner or management agent (O/A) or public housing agency (PHA) with certain information specified by the U.S. Department of Housing and Urban Development (HUD).

To make sure that the assistance is used properly, Federal laws require that the information you provide be verified. This information is verified in two ways:

1. HUD, O/As, and PHAs may verify the information you provide by checking with the records kept by certain public agencies (e.g., Social Security Administration (SSA), State agency that keeps wage and unemployment compensation claim information, and the Department of Health and Human Services' (HHS) National Directory of New Hires (NDNH) database that stores wage, new hires, and unemployment compensation). HUD (only) may verify information covered in your tax returns from the U.S. Internal Revenue Service (IRS). You give your consent to the release of this information by signing form HUD-9887. Only HUD, O/As, and PHAs can receive information authorized by this form.

2. The O/A must verify the information that is used to determine your eligibility and the amount of rent you pay. You give your consent to the release of this information by signing the form HUD-9887, the form HUD-9887-A, and the individual verification and consent forms that apply to you. Federal laws limit the kinds of information the O/A can receive about you. The amount of income you receive helps to determine the amount of rent you will pay. The O/A will verify all of the sources of income that you report. There are certain allowances that reduce the income used in determining tenant rents.

   Example: Mrs. Anderson is 62 years old. Her age qualifies her for a medical allowance. Her annual income will be adjusted because of this allowance. Because Mrs. Anderson's medical expenses will help determine the amount of rent she pays, the O/A is required to verify any medical expenses that she reports.

   Example: Mr. Harris does not qualify for the medical allowance because he is not at least 62 years of age and he is not handicapped or disabled. Because he is not eligible for the medical allowance, the amount of his medical expenses does not change the amount of rent he pays. Therefore, the O/A cannot ask Mr. Harris anything about his medical expenses and cannot verify with a third party about any medical expenses he has.

Customer Protections

Information received by HUD is protected by the Federal Privacy Act. Information received by the O/A or the PHA is subject to State privacy laws. Employees of HUD, the O/A, and the PHA are subject to penalties for using these consent forms improperly. You do not have to sign the form HUD-9887, the form HUD-9887-A, or the individual verification consent forms when they are given to you at your certification or recertification interview. You may take them home with you to read or to discuss with a third party of your choice. The O/A will give you another date when you can return to sign these forms.

If you cannot read and/or sign a consent form due to a disability, the O/A shall make a reasonable accommodation in accordance with Section 504 of the Rehabilitation Act of 1973. Such accommodations may include: home visits when the applicant's or tenant's disability prevents him/her from coming to the office to complete the forms; the applicant or tenant authorizing another person to sign on his/her behalf; and for persons with visual impairments, accommodations may include providing the forms in large script or braille or providing readers.

If an adult member of your household, due to extenuating circumstances, is unable to sign the form HUD-9887 or the individual verification forms on time, the O/A may document the file as to the reason for the delay and the specific plans to obtain the proper signature as soon as possible.

The O/A must tell you, or a third party which you choose, of the findings made as a result of the O/A verifications authorized by your consent. The O/A must give you the opportunity to contest such findings in accordance with HUD Handbook 4350.3 Rev. 1. However, for information received under the form HUD-9887 or form HUD-9887-A, HUD, the O/A, or the PHA, may inform you of these findings.

O/As must keep tenant files in a location that ensures confidentiality. Any employee of the O/A who fails to keep tenant information confidential is subject to the enforcement provisions of the State Privacy Act and is subject to enforcement actions by HUD. Also, any applicant or tenant affected by negligent disclosure or improper use of information may bring civil action for damages, and seek other relief, as may be appropriate, against the employee.

HUD-9887/A requires the O/A to give each household a copy of the Fact Sheet, and forms HUD-9887, HUD-9887-A along with appropriate individual consent forms. The package you will receive will include the following documents:

1. **HUD-9887/A Fact Sheet**: Describes the requirement to verify information provided by individuals who apply for housing assistance. This fact sheet also describes consumer protections under the verification process.
2. **Form HUD-9887:** Allows the release of information between government agencies.
3. **Form HUD-9887-A:** Describes the requirement of third party verification along with consumer protections.
4. **Individual verification consents:** Used to verify the relevant information provided by applicants/tenants to determine their eligibility and level of benefits.

Consequences for Not Signing the Consent Forms

If you fail to sign the form HUD-9887, the form HUD-9887-A, or the individual verification forms, this may result in your assistance being denied (for applicants) or your assistance being terminated (for tenants). See further explanation on the forms HUD-9887 and 9887-A.

If you are an applicant and are denied assistance for this reason, the O/A must notify you of the reason for your rejection and give you an opportunity to appeal the decision.

If you are a tenant and your assistance is terminated for this reason, the O/A must follow the procedures set out in the Lease. This includes the opportunity for you to meet with the O/A.

Programs Covered by this Fact Sheet

Rental Assistance Program (RAP)

Rent Supplement

Section 8 Housing Assistance Payments Programs (administered by the Office of Housing)

Section 202

Sections 202 and 811 PRAC

Section 202/162 PAC

Section 221(d)(3) Below Market Interest Rate

Section 236

HOPE 2 Home Ownership of Multifamily Units

O/As must give a copy of this HUD Fact Sheet to each household. See the Instructions on form HUD-9887-A.

Notice and Consent for the Release of Information

to the U.S. Department of Housing and Urban Development (HUD) and to an Owner and Management Agent (O/A), and to a Public Housing Agency (PHA)

U.S. Department of Housing and Urban Development
Office of Housing
Federal Housing Commissioner

HUD Office requesting release of information (Owner should provide the full address of the HUD Field Office, Attention: Director, Multifamily Division.):	O/A requesting release of information (Owner should provide the full name and address of the Owner.):	PHA requesting release of information (Owner should provide the full name and address of the PHA and the title of the director or administrator. If there is no PHA Owner or PHA contract administrator for this project, mark an X through this entire box.):

Notice To Tenant: Do not sign this form if the space above for organizations requesting release of information is left blank. You do not have to sign this form when it is given to you. You may take the form home with you to read or discuss with a third party of your choice and return to sign the consent on a date you have worked out with the housing owner/manager.

Authority: Section 217 of the Consolidated Appropriations Act of 2004 (Pub L. 108-199). This law is found at 42 U.S.C.653(J). This law authorizes HHS to disclose to the Department of Housing and Urban Development (HUD) information in the NDNH portion of the "Location and Collection System of Records" for the purposes of verifying employment and income of individuals participating in specified programs and, after removal of personal identifiers, to conduct analyses of the employment and income reporting of these individuals. Information may be disclosed by the Secretary of HUD to a private owner, a management agent, and a contract administrator in the administration of rental housing assistance.

Section 904 of the Stewart B. McKinney Homeless Assistance Amendments Act of 1988, as amended by section 903 of the Housing and Community Development Act of 1992 and section 3003 of the Omnibus Budget Reconciliation Act of 1993. This law is found at 42 U.S.C. 3544.This law requires you to sign a consent form authorizing: (1) HUD and the PHA to request wage and unemployment compensation claim information from the state agency responsible for keeping that information; and (2) HUD, O/A, and the PHA responsible for determining eligibility to verity salary and wage information pertinent to the applicant's or participant's eligibility or level of benefits; (3) HUD to request certain tax return information from the U.S. Social Security Administration (SSA) and the U.S. Internal Revenue Service (IRS).

Purpose: In signing this consent form, you are authorizing HUD, the above-named O/A, and the PHA to request income information from the government agencies listed on the form. HUD, the O/A, and the PHA need this information to verify your household's income to ensure that you are eligible for assisted housing benefits and that these benefits are set at the correct level. HUD, the O/A, and the PHA may participate in computer matching programs with these sources to verify your eligibility and level of benefits. This form also authorizes HUD, the O/A, and the PHA to seek wage, new hire (W-4), and unemployment claim information from current or former employers to verify information obtained through computer matching.

Uses of Information to be Obtained: HUD is required to protect the income information it obtains in accordance with the Privacy Act of 1974, 5 U.S.C. 552a. The O/A and the PHA is also required to protect the income information it obtains in accordance with any applicable State privacy law. After receiving the information covered by this notice of consent, HUD, the O/A, and the PHA may inform you that your eligibility for, or level of, assistance is uncertain and needs to be verified and nothing else.

HUD, O/A, and PHA employees may be subject to penalties for unauthorized disclosures or improper uses of the income information that is obtained based on the consent form.

Who Must Sign the Consent Form: Each member of your household who is at least 18 years of age and each family head, spouse or co-head, regardless of age, must sign the consent form at the initial certification and at each recertification. Additional signatures must be obtained from new adult members when they join the household or when members of the household become 18 years of age.

Persons who apply for or receive assistance under the following programs are required to sign this consent form:

Rental Assistance Program (RAP)

Rent Supplement

Section 8 Housing Assistance Payments Programs (administered by the Office of Housing)

Section 202; Sections 202 and 811 PRAC; Section 202/162 PAC Section

221(d)(3) Below Market Interest Rate

Section 236

HOPE 2 Homeownership of Multifamily Units

Failure to Sign Consent Form: Your failure to sign the consent form may result in the denial of assistance or termination of assisted housing benefits. If an applicant is denied assistance for this reason, the owner must follow the notification procedures in Handbook 4350.3 Rev. 1. If a tenant is denied assistance for this reason, the owner or managing agent must follow the procedures set out in the lease.

Consent: I consent to allow HUD, the O/A, or the PHA to request and obtain income information from the federal and state agencies listed on the back of this form for the purpose of verifying my eligibility and level of benefits under HUD's assisted housing programs.

Signatures:

Additional Signatures, if needed:

Head of Household	Date	Other Family Members 18 and Over	Date
Spouse	Date	Other Family Members 18 and Over	Date
Other Family Members 18 and Over	Date	Other Family Members 18 and Over	Date
Other Family Members 18 and Over	Date	Other Family Members 18 and Over	Date

Agencies To Provide Information

State Wage Information Collection Agencies. (HUD and PHA). This consent is limited to wages and unemployment compensation you have received during period(s) within the last 5 years when you have received assisted housing benefits.

U.S. Social Security Administration (HUD only). This consent is limited to the wage and self employment information from your current form W-2.

National Directory of New Hires contained in the Department of Health and Human Services' system of records. This consent is limited to wages and unemployment compensation you have received during period(s) within the last 5 years when you have received assisted housing benefits.

U.S. Internal Revenue Service (HUD only). This consent is limited to information covered in your current tax return.

This consent is limited to the following information that may appear on your current tax return:

1099-S Statement for Recipients of Proceeds from Real Estate Transactions

1099-B Statement for Recipients of Proceeds from Real Estate Brokers and Barters Exchange Transactions

1099-A Information Return for Acquisition or Abandonment of Secured Property

1099-G Statement for Recipients of Certain Government Payments

1099-DIV Statement for Recipients of Dividends and Distributions

1099 INT Statement for Recipients of Interest Income

1099-MISC Statement for Recipients of Miscellaneous Income

1099-OID Statement for Recipients of Original Issue Discount

1099-PATR Statement for Recipients of Taxable Distributions Received from Cooperatives

1099-R Statement for Recipients of Retirement Plans W2-G

Statement of Gambling Winnings

1065-K1 Partners Share of Income, Credits, Deductions, etc.

1041-K1 Beneficiary's Share of Income, Credits, Deductions, etc.

1120S-K1 Shareholder's Share of Undistributed Taxable Income, Credits, Deductions, etc.

I understand that income information obtained from these sources will be used to verify information that I provide in determining initial or continued eligibility for assisted housing programs and the level of benefits.

No action can be taken to terminate, deny, suspend, or reduce the assistance your household receives based on information obtained about you under this consent until the HUD Office, Office of Inspector General (OIG) or the PHA (whichever is applicable) and the O/A have independently verified: 1) the amount of the income, wages, or unemployment compensation involved, 2) whether you actually have (or had) access to such income, wages, or benefits for your own use, and 3) the period or periods when, or with respect to which you actually received such income, wages, or benefits. A photocopy of the signed consent may be used to request a third party to verify any information received under this consent (e.g., employer).

HUD, the O/A, or the PHA shall inform you, or a third party which you designate, of the findings made on the basis of information verified under this consent and shall give you an opportunity to contest such findings in accordance with Handbook 4350.3 Rev. 1.

If a member of the household who is required to sign the consent form is unable to sign the form on time due to extenuating circumstances, the O/A may document the file as to the reason for the delay and the specific plans to obtain the proper signature as soon as possible.

This consent form expires 15 months after signed.

Privacy Act Statement. The Department of Housing and Urban Development (HUD) is authorized to collect this information by the U.S. Housing Act of 1937, as amended (42 U.S.C. 1437 et. seq.); the Housing and Urban-Rural Recovery Act of 1983 (P.L. 98-181); the Housing and Community Development Technical Amendments of 1984 (P.L. 98-479); and by the Housing and Community Development Act of 1987 (42 U.S.C. 3543). The information is being collected by HUD to determine an applicant's eligibility, the recommended unit size, and the amount the tenant(s) must pay toward rent and utilities. HUD uses this information to assist in managing certain HUD properties, to protect the Government's financial interest, and to verify the accuracy of the information furnished. HUD, the owner or management agent (O/A), or a public housing agency (PHA) may conduct a computer match to verify the information you provide. This information may be released to appropriate Federal, State, and local agencies, when relevant, and to civil, criminal, or regulatory investigators and prosecutors. However, the information will not be otherwise disclosed or released outside of HUD, except as permitted or required by law. You must provide all of the information requested. Failure to provide any information may result in a delay or rejection of your eligibility approval.

Penalties for Misusing this Consent:
HUD, the O/A, and any PHA (or any employee of HUD, the O/A, or the PHA) may be subject to penalties for unauthorized disclosures or improper uses of information collected based on the consent form.

Use of the information collected based on the form HUD 9887 is restricted to the purposes cited on the form HUD 9887. Any person who knowingly or willfully requests, obtains, or discloses any information under false pretenses concerning an applicant or tenant may be subject to a misdemeanor and fined not more than $5,000.

Any applicant or tenant affected by negligent disclosure of information may bring civil action for damages, and seek other relief, as may be appropriate, against the officer or employee of HUD, the Owner or the PHA responsible for the unauthorized disclosure or improper use.

Applicant's/Tenant's Consent to the Release of Information

Verification by Owners of Information
Supplied by Individuals Who Apply for Housing Assistance

U.S. Department of Housing and Urban Development
Office of Housing
Federal Housing Commissioner

Instructions to Owners

1. Give the documents listed below to the applicants/tenants to sign. Staple or clip them together in one package in the order listed.
   a. The HUD-9887/A Fact Sheet.
   b. Form HUD-9887.
   c. Form HUD-9887-A.
   d . Relevant verifications (HUD Handbook 4350.3 Rev. 1).
2. Verbally inform applicants and tenants that
   a. They may take these forms home with them to read or to discuss with a third party of their choice and to return to sign them on a date they have worked out with you, and
   b. If they have a disability that prevents them from reading and/ or signing any consent, that you, the Owner, are required to provide reasonable accommodations.
3. Owners are required to give each household a copy of the HUD9887/A Fact Sheet, form HUD-9887, and form HUD-9887-A after obtaining the required applicants/tenants signature(s). Also, owners must give the applicants/tenants a copy of the signed individual verification forms upon their request.

Instructions to Applicants and Tenants

This Form HUD-9887-A contains customer information and protections concerning the HUD-required verifications that Owners must perform.

1. Read this material which explains:
   • HUD's requirements concerning the release of information, and
   • Other customer protections.
2. Sign on the last page that:
   • you have read this form, or
   • the Owner or a third party of your choice has explained it to you, and
   • you consent to the release of information for the purposes and uses described.

Authority for Requiring Applicant's/Tenant's Consent to the Release of Information

Section 904 of the Stewart B. McKinney Homeless Assistance Amendments Act of 1988, as amended by section 903 of the Housing and Community Development Act of 1992. This law is found at 42 U.S.C. 3544.

In part, this law requires you to sign a consent form authorizing the Owner to request current or previous employers to verify salary and wage information pertinent to your eligibility or level of benefits.

In addition, HUD regulations (24 CFR 5.659, Family Information and Verification) require as a condition of receiving housing assistance that you must sign a HUD-approved release and consent authorizing any depository or private source of income to furnish such information that is necessary in determining your eligibility or level of benefits. This includes information that you have provided which will affect the amount of rent you pay. The information includes income and assets, such as salary, welfare benefits, and interest earned on savings accounts. They also include certain adjustments to your income, such as the allowances for dependents and for households whose heads or spouses are elderly handicapped, or disabled; and allowances for child care expenses, medical expenses, and handicap assistance expenses.

Purpose of Requiring Consent to the Release of Information

In signing this consent form, you are authorizing the Owner of the housing project to which you are applying for assistance to request information from a third party about you. HUD requires the housing owner to verify all of the information you provide that affects your eligibility and level of benefits to ensure that you are eligible for assisted housing benefits and that these benefits are set at the correct levels. Upon the request of the HUD office or the PHA (as Contract Administrator), the housing Owner may provide HUD or the PHA with the information you have submitted and the information the Owner receives under this consent.

Uses of Information to be Obtained

The individual listed on the verification form may request and receive the information requested by the verification, subject to the limitations of this form. HUD is required to protect the income information it obtains in accordance with the Privacy Act of 1974, 5 U.S.C. 552a. The Owner and the PHA are also required to protect the income information they obtain in accordance with any applicable state privacy law. Should the Owner receive information from a third party that is inconsistent with the information you have provided, the Owner is required to notify you in writing identifying the information believed to be incorrect. If this should occur, you will have the opportunity to meet with the Owner to discuss any discrepancies.

Who Must Sign the Consent Form

Each member of your household who is at least 18 years of age, and each family head, spouse or co-head, regardless of age must sign the relevant consent forms at the initial certification, at each recertification and at each interim certification, if applicable. In addition, when new adult members join the household and when members of the household become 18 years of age they must also sign the relevant consent forms.

Persons who apply for or receive assistance under the following programs must sign the relevant consent forms:

Rental Assistance Program (RAP)
Rent Supplement
Section 8 Housing Assistance Payments Programs (administered by the Office of Housing)
Section 202
Sections 202 and 811 PRAC
Section 202/162 PAC
Section 221(d)(3) Below Market Interest Rate
Section 236
HOPE 2 Home Ownership of Multifamily Units

Failure to Sign the Consent Form

Failure to sign any required consent form may result in the denial of assistance or termination of assisted housing benefits. If an applicant is denied assistance for this reason, the O/A must follow the notification procedures in Handbook 4350.3 Rev. 1. If a tenant is denied assistance for this reason, the O/A must follow the procedures set out in the lease.

Conditions

No action can be taken to terminate, deny, suspend or reduce the assistance your household receives based on information obtained about you under this consent until the O/A has independently 1) verified the information you have provided with respect to your eligibility and level of benefits and 2) with respect to income (including both earned and unearned income), the O/A has verified whether you actually have (or had) access to such income for your own use, and verified the period or periods when, or with respect to which you actually received such income, wages, or benefits.

A photocopy of the signed consent may be used to request the information authorized by your signature on the individual consent forms. This would occur if the O/A does not have another individual verification consent with an original signature and the O/A is required to send out another request for verification (for example, the third party fails to respond). If this happens, the O/A may attach a photocopy of this consent to a photocopy of the individual verification form that you sign. To avoid the use of photocopies, the O/A and the individual may agree to sign more than one consent for each type of verification that is needed. The O/A shall inform you, or a third party which you designate, of the findings made on the basis of information verified under this consent and shall give you an opportunity to contest such findings in accordance with Handbook 4350.3 Rev. 1.

The O/A must provide you with information obtained under this consent in accordance with State privacy laws.

If a member of the household who is required to sign the consent forms is unable to sign the required forms on time, due to extenuating circumstances, the O/A may document the file as to the reason for the delay and the specific plans to obtain the proper signature as soon as possible.

Individual consents to the release of information expire 15 months after they are signed. The O/A may use these individual consent forms during the 120 days preceding the certification period. The O/A may also use these forms during the certification period, but only in cases where the O/A receives information indicating that the information you have provided may be incorrect. Other uses are prohibited.

The O/A may not make inquiries into information that is older than 12 months unless he/she has received inconsistent information and has reason to believe that the information that you have supplied is incorrect. If this occurs, the O/A may obtain information within the last 5 years when you have received assistance.

I have read and understand this information on the purposes and uses of information that is verified and consent to the release of information for these purposes and uses.

_____

Name of Applicant or Tenant (Print)

_____

Signature of Applicant or Tenant & Date

I have read and understand the purpose of this consent and its uses and I understand that misuse of this consent can lead to personal penalties to me.

_____

Name of Project Owner or his/her representative

_____

Title

_____

Signature & Date
cc:Applicant/Tenant
Owner file

Penalties for Misusing this Consent:

HUD, the O/A, and any PHA (or any employee of HUD, the O/A, or the PHA) may be subject to penalties for unauthorized disclosures or improper uses of information collected based on the consent form.

Use of the information collected based on the form HUD 9887-A is restricted to the purposes cited on the form HUD 9887-A. Any person who knowingly or willfully requests, obtains or discloses any information under false pretenses concerning an applicant or tenant may be subject to a misdemeanor and fined not more than $5,000.

Any applicant or tenant affected by negligent disclosure of information may bring civil action for damages, and seek other relief, as may be appropriate, against the officer or employee of HUD, the O/A or the PHA responsible for the unauthorized disclosure or improper use.

Exhibit 5-8: Tenant Rent Formulas

Section 8, RAP, PRAC, PAC

Total Tenant Payment (TTP) is the greater of:

- 30% monthly adjusted income;
- 10% monthly gross income;
- Welfare rent (welfare recipients in as-paid localities only); or
- $25 minimum rent (Section 8 only).

NOTE: An owner may admit an applicant to the Section 8, RAP, and PAC programs only if the TTP is less than the gross rent. This note does not apply to the PRAC program. In some instances under the PRAC program a tenant's TTP will exceed the PRAC operating rent (gross rent).

Rent Supplement

Total Tenant Payment (TTP) is the greater of:

- 30% of monthly adjusted income; or
- 30% of gross rent.

NOTE: For move-ins and initial certifications, the amount of Rent Supplement assistance may be no less than 10% of the gross rent. If the initial amount of Rent Supplement assistance would be less than 10% of the gross rent, the tenant is not eligible for Rent Supplement Assistance.

Section 236—No Utility Allowance

Tenant rent is the greater of:

- 30% of monthly adjusted income; or
- Section 236 basic rent.

Tenant rent is never more than market rent.

Section 236—With Utility Allowance

Tenant rent is the greater of:

- 30% of the monthly adjusted income less the utility allowance;
- 25% of monthly adjusted income; or
- Basic rent.

Tenant rent is never more than market rent.

Section 221(d)(3) BMIR (Below Market Interest Rate)

At move-in or initial certification, if the tenant's annual income is:

- At or below the BMIR income limit, the tenant is charged the BMIR rent.
- Above the BMIR income limit, the tenant may not be admitted to the project.

At recertification, if the tenant's annual income is:

- Less than or equal to 110% of the BMIR income limit, the tenant pays the BMIR rent.
- Greater than 110% of the BMIR income limit, the tenant pays 110% of the BMIR rent.

Section 24

HUD 4350.3 REV-1 Appendix 6 :
Verification and Consent,
Guidance and Sample Forms

APPENDIX 6: VERIFICATION AND CONSENT – GUIDANCE AND SAMPLE FORMATS

This appendix contains three components.

Appendix 6-A: Guidance for Development of Individual Consent Forms describes the required language that must be used when obtaining an applicant/tenant's consent to seek third-party verification of eligibility and income information, as well as a sample format.

Appendix 6-B: Verification of Disability – Instructions to Owners and Sample Formats provides additional instructions and sample formats for verifying an applicant/tenant's disability status for eligibility, or for receiving allowable income deductions based on disability.

Appendix 6-C: Guidance About Types of Information to Request When Verifying Eligibility and Income presents guidance about the types of information that are appropriate when an owner is seeking to verify an applicant/tenant's eligibility or income information.

Appendix 6-A: Guidance for Development of Individual Consent Forms

1. REQUIREMENTS FOR INDIVIDUAL CONSENT. See sample consent below. Individual verification consent forms must contain the following consumer protections:

   a. State in bold (or other emphasis) in a prominent place that the applicant/tenant does not have to sign the consent if it is not clear who will provide the information or who will receive the information.

      NOTE: This can be re-worded to suit the owner's individual style. This customer protection assures individuals that their consents will be used by authorized individuals only.

      "NOTE: This information may have to be conveyed in languages other than English for LEP persons in accordance with HUD guidance."

   b. Include the following statement on the penalties for misusing the consent:

      "Title 18, Section 1001 of the U.S. Code states that a person is guilty of a felony for knowingly and willingly making false or fraudulent statements to any department of the United States Government. HUD and any owner (or any employee of HUD or the owner) may be subject to penalties for unauthorized disclosures or improper uses of information collected based on the consent form. Use of the information collected based on this verification form is restricted to the purposes cited above. Any person who knowingly or willingly requests, obtains or discloses any information under false pretenses concerning an applicant or participant may be subject to a misdemeanor and fined not more than $5,000. Any applicant or participant affected by negligent disclosure of information may bring civil action for damages and seek other relief, as may be appropriate, against the officer or employee of HUD or the owner responsible for the unauthorized disclosure or improper use. Penalty provisions for misusing the social security number are contained in the Social Security Act at **208 (a) (6), (7) and (8).** Violation of these provisions are cited as violations of 42 U.S.C. Section **408 (a) (6), (7) and (8).**

   c. Request only that information necessary to determine the person's eligibility or level of assistance.

EXAMPLE – Information That Is Not Necessary to Determine Eligibility or Level of Assistance

In a verification for termination of employment, it would not be appropriate to ask “would you rehire this person?” But, it would be appropriate to ask “do you anticipate rehiring this person and, if yes, when?”

In a medical verification, it would not be appropriate to ask the purpose of an office visit or to ask for a diagnosis.

NOTE: Concerning verifications of disability (handicap), **Appendix 6-B** provides a specific explanation to the applicant/tenant on the limitations on any verification of disability (handicap).

d. Include the following certification statement to be signed by the applicant/tenant:

"I hereby authorize the release of the requested information. Information obtained under this consent is limited to information that is no older than 12 months. There are circumstances that would require the owner to verify information that is up to 5 years old, which would be authorized by me on a separate consent attached to a copy of this consent."

e. Provide a space for the title, agency/organization, and signature of the third party who is supplying the information. This information will be provided by the third party. For example:

_____	_____
NAME AND TITLE OF PERSON SUPPLYING THE INFORMATION (PRINT)	AGENCY/ORGANIZATION
_____	_____
SIGNATURE	DATE

2. SAMPLE VERIFICATION CONSENT FORMAT

The format on the next page shows a sample of how consent for verification may be requested.

SAMPLE VERIFICATION CONSENT

DATE:

TO: (Name and address of third party who is being requested to verify this information)

FROM: (Name of individual requesting the information, title, name of housing project, address)

RETURN THIS VERIFICATION TO THE PERSON LISTED ABOVE (or other instruction to the third party to ensure that the verification is returned to the right person. This is important because owners have a responsibility to treat this information confidentially.)

SUBJECT: Verification of Information Supplied by an Applicant for Housing Assistance

NAME _____

ADDRESS _____

This person has applied for housing assistance under a program of the U.S. Department of Housing and Urban Development (HUD). HUD requires the housing owner to verify all information that is used in determining this person's eligibility or level of benefits.

We ask your cooperation in providing the following information and returning it to the person listed at the top of the page. Your prompt return of this information will help to ensure timely processing of the application for assistance. Enclosed is a self-addressed, stamped envelope for this purpose. The applicant/tenant has consented to this release of information as shown below.

==========

INFORMATION BEING REQUESTED

(Owners: Fill in here the information requested. Consult **Appendix 6-C** of this handbook for examples of relevant information that owners may request from third parties in verifying several types of income and information and household characteristics. This list of information is not meant to be all-inclusive. Owners may add other information as long as any additional information is relevant to determining the individual's eligibility for assistance or level of benefits. This instruction does not have to appear on an individual consent.)

_____ _____

Name and Title of Person Supplying the Information | Firm/Organization

_____ _____

Signature | Date

==========

==========

RELEASE: I hereby authorize the release of the requested information. Information obtained under this consent is limited to information that is no older than 12 months. There are circumstances that would require the owner to verify information that is up to 5 years old, which would be authorized by me on a separate consent attached to a copy of this consent.

_____ _____

Signature Date

Note to Applicant/Tenant: You do not have to sign this form if either the requesting organization or the organization supplying the information is left blank.

==========

PENALTIES FOR MISUSING THIS CONSENT:

Title 18, Section 1001 of the U.S. Code states that a person is guilty of a felony for knowingly and willingly making false or fraudulent statements to any department of the United States Government. HUD and any owner (or any employee of HUD or the owner) may be subject to penalties for unauthorized disclosures or improper uses of information collected based on the consent form. Use of the information collected based on this verification form is restricted to the purposes cited above. Any person who knowingly or willingly requests, obtains, or discloses any information under false pretenses concerning an applicant or participant may be subject to a misdemeanor and fined not more than $5,000. Any applicant or participant affected by negligent disclosure of information may bring civil action for damages and seek other relief, as may be appropriate, against the officer or employee of HUD or the owner responsible for the unauthorized disclosure or improper use. Penalty provisions for misusing the social security number are contained in the Social Security Act at **208 (a) (6), (7) and (8).** Violations of these provisions are cited as violations of 42 USC **408 (a) (6), (7) and (8).**

We Do Business in Accordance With the Federal Fair Housing Law

(The Fair Housing Amendments Act of 1988)

Appendix 6-B: Verification of Disability – Instructions to Owners and Sample Formats

NOTE: These verification instructions and sample formats are not to be used when assigning accessible units.

1. EXPLANATION TO THE APPLICANT

(**Instruction to Owners:** This explanation is required. It may be in the form of a cover letter or may appear directly on the verification consent. Owners may edit the following explanation as long as the same message is conveyed. This instruction does not have to appear on the verification consent.)

HUD permits owners to verify that you have a disability only if:

1) Your eligibility for admission is dependent on your being a person with a disability; or

2) You claim eligibility for deductions that are given to a person with a disability.

The definitions of disability vary depending on the project you are applying for or living in. The owner determines the definition(s) to use by consulting with HUD Handbook 4350.3 REV-1. The third party from whom this verification is being requested has knowledge of whether your disability meets the applicable definition(s) of disability (or person with a disability). An owner may request from a third party only the minimum information necessary to determine whether you meet the applicable definition of disability (or person with a disability). Any other request for information about you is not relevant and may not be asked (e.g., diagnosis, treatment plan).

"NOTE: This information may have to be conveyed in languages other than English for LEP persons in accordance with HUD guidance."

2. SAMPLE FORMATS

The two sample formats on the next page can be used to verify an applicant/tenant's disability status for purposes of eligibility for occupancy in properties/units where occupancy is restricted to disabled families or persons with disabilities, or for income deductions based on disability when determining an applicant/tenant's adjusted income.

Please note that if Item 4, on either sample format, is checked "YES", the applicant/tenant does not meet HUD's definition of disability.

HUD- 90102 - SAMPLE VERIFICATION OF DISABILITY WHEN ELIGIBILITY FOR ADMISSION OR QUALIFICATION FOR CERTAIN INCOME DEDUCTIONS IS BASED ON DISABILITY

FOR USE WITH **SECTION 202/8**, **SECTION 202 PAC**, **Section 202 PRAC,** AND **SECTION 811 PRAC**

http://www.hud.gov/offices/adm/hudclips/forms/files/90102.pdf

HUD -90103 - SAMPLE VERIFICATION OF DISABILITY WHEN ELIGIBILITY FOR ADMISSION OR QUALIFICATION FOR CERTAIN INCOME DEDUCTIONS IS BASED ON DISABILITY

FOR USE WITH ALL PROGRAMS **EXCEPT** SECTION 202/8, SECTION 202 PAC, SECTION 202 PRAC, AND SECTION 811 PRAC

http://www.hud.gov/offices/adm/hudclips/forms/files/90103.pdf

Appendix 6-C: Guidance About Types of Information to Request When Verifying Eligibility and Income

Paragraph 1.c of **Appendix 6-A** states that owners may request only that information necessary to determine the person's eligibility or level of assistance. The first paragraph under most of the types of income listed below provides information that would meet this requirement. For some types of income listed below, appropriate requests for information are combined with the types of verification that are permitted. In deciding whether to add information to a particular verification request that is not listed below, the owner must ask: Is this information necessary to determine the individual's eligibility for assistance or level of assistance? If the answer is "yes", then the owner may verify that information. If the answer is "no", then the owner may not verify that information

"NOTE: This information may have to be conveyed in languages other than English for LEP persons in accordance with HUD guidance."

A. Employment Income

1. Relevant information to verify with third party:

   a. Nonmilitary employment

      (1) Date first employed,

      (2) Base pay rate (Gross) (check one)

      Per hour $_____ or per week $_____

      OR per month $_____

      Date present rate became effective _____

      Expected average hours to be worked during next 12 calendar months at base pay rate _____

      Per week _____ or per month_____,

      (3) Overtime pay rate

      Per hour $_____

      Expected average number of hours to be worked per week during next 12 calendar months _____,

      (4) Other compensation not included above (specify for commissions, bonuses, tips, etc.)

      For _____ $_____ per _____,

(5) Total anticipated base pay earnings for the next 12 calendar months $_____,

Total anticipated overtime earnings for the next 12 calendar months $_____,

(6) Medical insurance premium deducted (if any). (This would be relevant only for families eligible for the medical deduction.),

_____

(7) Has employment been terminated? _____

If yes, is individual eligible for unemployment benefits?

_____

b. Military employment

(1) Years ____ and months _____ of services for pay purposes.

Number of dependents claimed_____,

(2) Monthly income from the following sources:

Base pay and longevity pay	$_____
Proficiency pay	$_____
Sea and foreign duty pay	$_____
Hazardous duty pay	$_____
Imminent danger pay	$_____
Subsistence allowance	$_____
Quarters allowance (Include only amount contributed by government)	$_____
Other (explain)	$_____
TOTAL AMOUNT RECEIVED MONTHLY	$_____.

2. Acceptable forms of verification:

a. Employment verification form completed by the employer verifying frequency of pay, effective date of the last pay increase, and probability and effective date of any increase during the next 12 months;

b. Check stubs or earning statements showing employee's gross pay per pay period and frequency of pay;

c. W-2 forms if applicant has had the same job for at least two years and pay increases can be accurately projected; and

d. Notarized statements, affidavits or income tax returns signed by the applicant describing self-employment and amount of income or income from tips and other gratuities.

B. **Date Employment Terminated**

1) Relevant information to verify with third party:

a. Date of hire;

b. Date of termination;

c. Last day actually worked;

d. Do you anticipate rehiring this employee? If yes, when?

e. Will the employee receive additional paychecks for worker's compensation?

If yes, provide the name and address of the company through which this can be verified.

f. Is employee eligible for unemployment benefits?

g. Total severance pay anticipated for the next 12 months.

2. Acceptable forms of verification:

a. Termination of employment verification;

b. Letter from employer stating date of termination; and

c. Letter from an agency providing unemployment compensation stating that the individual's employment terminated and that unemployment benefits will begin.

C. **Social Security and Supplementary Security Income (SSI)**

1. Relevant information to verify *Social Security and SSI income.* The following information is generally available from *EIV or the* award or benefit letter *or the Proof of Income Letter*.

a. Name of original annuitant;

b. Pension claim number or social security number of person receiving the pension claim;

c. Current monthly gross amount of pension or annuity;

d. Deductions from gross amount for medical insurance premiums;

e. Date benefits began;

f. Effective date of current amount;

g. For social security, ask: Has the monthly payment been reduced for overpayment of previous benefits? If so, by how much?

2) Acceptable forms of verification:

a. Initial occupancy. At initial occupancy, acceptable forms of verification are:

- Benefit verification form completed by agency providing the benefits;
- Award or benefit notification letters prepared and signed by the authorizing agency. (Since checks or bank deposit slips show only net amounts remaining after deducting supplemental security income or Medicare, they may be used only when award letters can't be obtained.) If the applicant does not have his or her award letter, the applicant may obtain it by calling 800-772-1213.

b. Annual recertification. At annual recertification, the owner *must* verify benefit information by obtaining a Benefit History Report from *EIV*. If the owner cannot obtain this report from *EIV*, the owner uses the verification methods for initial occupancy.

NOTE: Failure to obtain a Benefit History Report from *EIV* is not an indication that the tenant does not receive benefits. Due to data sharing limitations between existing data systems, it is possible for a tenant to receive benefits on which the owner cannot obtain a Benefit History Report.

D. Pensions and Disability Income Other Than from the Social Security Administration

This paragraph is not suggesting that owners group verifications of these different sources of income into one verification. Owners may have to adapt the questions, depending on the source of income being verified. This paragraph provides suggestions on the types of questions that are appropriate to ask a third party.

1. Relevant information to verify with third party:

a. Name of original annuitant;

b. Pension claim number or social security number of person receiving the pension claim;

c. Current monthly gross amount of pension or annuity;

d. Deductions from gross amount for medical insurance premiums;

e. Date benefits began;

f. Effective date of current amount;

g. For annuities, ask: Did the individual invest in an annuity? If yes, what is the amount invested? What is the amount received to date from the annuity? Does the individual receive regular payments? When are they received (monthly, annually)?

h. For pensions and annuities, ask: Is the individual reimbursed for medical costs?

2) Acceptable forms of verification:

a. Benefit verification form completed by the company/agency providing the benefits;

b. Award or benefit notification letters prepared and signed by the authorizing company/agency. (Checks or bank deposit slips show only net amounts remaining after deductions.)

E. **Unemployment Compensation**

1. Relevant information to verify with third party:

a. Gross weekly payment;

b. Date of initial payment;

c. Duration of benefits: _____ weeks;

d. Is the claimant eligible for further benefits?

e. If yes, how many weeks?

f. If no, what is the date the benefits are terminated?

2. Acceptable forms of verification:

a. Verification form completed by the unemployment compensation agency; and

b. Records from unemployment office stating payment dates and amounts.

F. **Public Benefits**

1. Relevant information to verify with third party:

a. Number of members in the family;

b. Names of the children for whom benefits are received and their social security numbers;

c. Date of initial assistance;

d. Is recipient covered by Medicaid? If yes, what is the Medicare spend down amount?

e. Does the recipient meet his/her spend down amount each period?

f. What is the rate per month under the following grant:

(1) Temporary Assistance to Needy Families (TANF),

(2) Supplemental Social Security,

(3) Other assistance: Type _____, and

g. The following question applies only to "as-paid" States only: Amount specifically designated for shelter and utilities (This is the maximum allowance for rent and utilities);

h. The grant is increased by the following amounts (Specify purpose):

(1) Employment income $ _____

(2) Child care allowance $ _____

(3) Transportation $ _____

(4) Other _____ $ _____;

i. The grant is reduced by the following amounts:

(1) Alimony $_____

(2) Child support $_____

(3) Other (specify) $_____;

j. Is there anything else that will influence the amount of the grant? If yes, specify purpose and amount. $_____

k. Has the monthly payment been reduced for overpayment of previous benefits? If so, by how much? $_____

l. TOTAL MONTHLY GRANT $ _____.

2. Acceptable forms of verification:

a. All welfare programs. Welfare agency's written statements as to type and amount of assistance family is now receiving and any changes in assistance expected during the next 12 months;

b. Additional information for "as-paid" programs. Welfare agency's written schedule or statement that describes how the "as-paid" system works, the maximum amount a family may receive for shelter and utilities and, if applicable, any factors used to ratably reduce the client's grant.

G. **Alimony or Child Support Payments**

1. Relevant information to verify with third party:

a. Amount of alimony or child support being provided to the family;

b. Will such amounts be terminated within the next 12 months. If so, when?

2. Acceptable forms of verification:

a. Copy of a separation or settlement agreement or divorce decree stating amount and type of support and payment schedules;

b. A letter from the person paying the support;

c. Copy of latest check. Owner must record the date, amount, and number of check; and

d. Applicant's notarized statement or affidavit of amount received or that support payments are not being received and the likelihood of support payments being received in the future.

H. **Net Income from a Business**

The following documents show income for the prior years. Owners must consult with tenants and use this data to estimate income for the next 12 months.

1. IRS Tax Return, Form 1040, including any:

a. Schedule C (Small Business);

b. Schedule E (Rental Property Income); and

c. Schedule F (Farm Income).

2. An accountant's calculation of depreciation expense, computed using straight-line depreciation rules. (Required when accelerated depreciation was used on the tax return or financial statement.)

3. Audited or unaudited financial statement(s) of the business.

4. Loan Application listing income derived from the business during the previous 12 months.

5. Applicant's notarized statement or affidavit as to net income realized from the business during the previous years.

I. **Recurring Gifts**

Acceptable forms of verification:

1. Notarized statement or affidavit signed by the person providing the assistance. It must give the purpose, dates and value of gifts.

2. Applicant's notarized statement or affidavit that provides the purpose, dates and value of gifts.

J. **Family Assets Now Held**

1) Relevant information to verify with third party:

For non-liquid assets, collect enough information to determine the current cash value—the net amount the family would receive if the asset were converted to cash. (See paragraph 5.7.)

a. Type of account;

b. Current balance or, for checking accounts, the average balance for the last six months;

c. Date account opened;

d. Date account closed;

e. Is this an interest bearing account? If so, what is the interest rate?

f. For trusts:

(1) What is the value of the trust fund?

(2) What is the anticipated amount of income to be earned by the trust over the next 12 months?

(3) What is the amount anticipated to be distributed over the next 12 months?

g, For property, what is the equity value?

2) Acceptable forms of verification:

a. Verification forms, letters, or documents from a financial institution, broker, etc.;

NOTE: When financial institutions charge a fee to the applicant or tenant for providing verifications, the forms of verification in paragraph b) below would be the preferred method.

b. Account statements, passbooks, broker's quarterly statements showing value of stocks or bonds, etc., and the earnings credited to the applicant's account statements, or financial statements completed by a financial institution or broker;

NOTE: The owner must adjust the information provided by the financial institution to project earnings expected for the next 12 months.

c. Quotes from a stockbroker or realty agent as to net amount family would receive if they liquidated securities or real estate;

d. Copy of IRS Form 1099 prepared by the financial institution showing the amount of income provided by the asset;

e. Real estate tax statements if tax authority uses approximately market value;

f. Copies of closing documents showing the selling price, the distribution of the sales proceeds and the net amount to the individual;

g. Appraisals of personal property held as an investment; and

h. Applicant's notarized statements or signed affidavits describing assets or verifying cash held at the applicant's home or in safe deposit boxes.

K. **Assets Disposed of for Less than Fair Market Value During Two Years Preceding Effective Date of Certification or Recertification**

(See paragraph 5.7 G.6.) Suggested information to obtain and acceptable forms of verification are included below.

1. For all certifications and recertifications except those prepared for BMIR tenants, certification as to whether any member *of the family* has disposed of assets for less than fair market value during the two years preceding effective date of the certification or recertification.

2. If the family certifies that they did dispose of assets for less than fair market value a certification that shows:

   a. All assets disposed of for less than fair market value;

   b. The date they disposed of the assets;

c. The amount the family received; and

d. The market value *of the asset(s)* at the time of disposition.

L. **Income from Sale of Real Property Pursuant to a Purchase Money Mortgage, Installment Sales Contract, or Similar Arrangement**

The following provide suggested information to verify with a third party and acceptable forms of verification:

1. A letter from an accountant, attorney, real estate broker, the buyer, or a financial institution stating interest due for next 12 months. (A copy of the check paid by the buyer to the applicant is not sufficient since appropriate breakdowns of interest and principal are not included.)

2. Amortization schedule showing interest for the 12 months following the effective date of the certification or recertification.

M. **Rental Income from Property Owned by Applicant/Tenant**

The following provide suggested information to verify with a third party and acceptable forms of verification:

1. IRS Form 1040 with Schedule E (Rental Income).

2. Copies of latest rent checks, leases, or utility bills.

3. Documentation of applicant's/tenant's income and expenses in renting the property (tax statements, insurance premiums, receipts for reasonable maintenance and utilities, bank statements or amortization schedules showing monthly interest expense).

4. Lessee's written statement identifying monthly payments due the applicant and applicant's affidavit as to net income realized.

N. **Full-Time Student Status**

The following provide suggested information to verify with a third party and acceptable forms of verification:

1. Written verification from the registrar's office or appropriate school official.

2. School records indicating enrollment for sufficient number of credits to be considered a full-time student by the school.

O. **Child Care Expenses**

The following provide suggested information to verify with a third party and acceptable forms of verification:

1. Written verification from the person who receives the payments.

2. Verifications must specify the hours and days during which the care is provided, the names and ages of the children cared for, and the frequency and amount of compensation received. (Owners should recognize that child care costs may be higher during summer and holiday recesses.)

   NOTE: Owners may want to ask the verifying party to indicate children age 12 or younger.

3. Applicant's certification as to whether any of those payments have been or will be reimbursed by outside sources.

   NOTE: Owners may wish to use separate verification consents for child care and disability (handicap) care.

P. **Medical Expenses**

The following provide suggested information to verify with a third party and acceptable forms of verification:

1. Written verification by a doctor, hospital or clinic personnel, dentist, pharmacist, etc., of:

   a. The estimated medical costs to be incurred by the applicant and of regular payments due on medical bills;

   b. The extent to which those expenses will be reimbursed by insurance or a government agency; and

   c. Whether the provider accepts Medicare assignment.

2. The insurance company's or employer's written confirmation of health insurance premiums to be paid by the applicant.

3. Social Security Administration's written confirmation of Medicare premiums to be paid by the applicant over the next 12 months.

4. For attendant care:

   a. Doctor's certification that the assistance of an attendant is medically necessary;

   b. Attendant's written confirmation of hours of care provided and amount and frequency of payments received from the family (or copies of cancelled checks the family used to make those payments); and

   c. Applicant's certification as to whether any of those payments have been or will be reimbursed by outside sources.

5. Receipts, cancelled checks, or pay stubs that indicate health insurance premium costs, etc., that verify medical and insurance expenses likely to be incurred in the next 12 months.

6. Copies of payment agreements with medical facilities or cancelled checks that verify payments made on outstanding medical bills that will continue over all or part of the next 12 months.

7. Receipts or other record of medical expenses incurred during the past 12 months that can be used to anticipate future medical expenses. Owners may use this approach for "general medical expenses" such as non-prescription drugs and regular visits to doctors or dentists, but not for one-time, nonrecurring expenses from the previous year.

Q. **Need for Larger Unit Because of Physical or Mental Disability (Handicap)**

The owner may request additional information to verify the request for a larger unit as a reasonable accommodation. The owner may request reliable disability-related information to verify that the requestor meets the definition of disability, that the accommodation is needed, and that the need is related to the disability. Such information may be, but need not be, provided by a health care professional. It could be provided by a non-medical service coordinator or service provider, a peer support group, or other reliable third party who is in the position to know about the requestor's disability.

R. **Disabled (Handicap) Assistance Expense**

1. Attendant care:

   a. Attendant's written certification as to amount received from the applicant/tenant, frequency of receipt, hours of care provided, and/or copies of cancelled checks applicant/tenant used to make those payments; and

   b. Family's written certification as to whether they receive reimbursement for any of the attendant care expenses and the amount of any reimbursement received.

2) Auxiliary apparatus: Receipts for purchases of, or evidence of monthly payments for auxiliary apparatus.

3) In all cases:

   a. As routine practice, owners should accept the individual's written statement that an auxiliary apparatus or attendant care is necessary for employment. If the owner determines that verification is necessary in a particular case, the owner should obtain written certification from a *reliable source* that the family member who is a person with a disability (handicap) requires the services of an attendant or the use of auxiliary apparatus to permit this family member to be employed or to enable

another family member to be employed. *See* Chapter 2 regarding individuals' requests for reasonable accommodations.

b. Family's written certification as to whether they receive reimbursement for any of the auxiliary apparatus expenses and the amount of any reimbursement received.

S. **Family Type and Membership in Family**

1. For elderly household where the head, co-head, or spouse is 62 years of age or older verification of age may be provided by:

   a. Copy of a birth certificate, baptismal certificate, census record, official record of birth or other authoritative document; or

   b. Receipt of supplemental security income old age benefits or social security retirement benefits.

2. For disability (because the individual's eligibility for admission is dependent on his/her being a person with a disability [handicap] or because the individual claims eligibility for income deductions that are given to persons with disabilities [handicaps]) verification of disability (handicap) may be provided by:

   a. Receipt of supplemental social security disability or social security disability benefits, which would provide verification that an individual met the definition of "person with disabilities" as shown in Definition E of Figure 3-6 in Chapter 3 of this handbook; or

   b. *Verification* by a *reliable source* that the individual meets the relevant definition of a "person with a disability (handicap)" for the particular project. *See Chapter 2 regarding individuals' requests for reasonable accommodations.*

      IMPORTANT: See **Appendix 6-B** for the limitations on information that may be verified. **Appendix 6-B** also requires the owner to provide an explanation to the applicant/tenant describing these limitations. In particular, the consent should request the third party to identify any of the relevant definitions that apply to the individual. Any other request for information about the individual is not relevant and may not be asked (e.g., diagnosis, treatment plan).

3. For family members younger than age 18, verification of age may be provided by birth certificate, adoption papers, and/or custody agreements.

T. **Statutory and HUD Regulatory Preferences – Displacement by Government Action or Presidentially Declared Disaster**

(Applicable only to 221(d)(3) BMIR and Section 236 units):

1. <u>Relevant information to verify with third party:</u>

Date of displacement, or, if displacement has not yet occurred, the anticipated date of displacement; The applicant will be displaced if the applicant has vacated or will have to vacate his/her housing unit as a result of one or both of the following actions:

a. A presidentially declared disaster, such as a hurricane, flood or fire, that has made the unit uninhabitable; or

b. Code enforcement, public improvement, or development program activities by a U.S. agency or a State or local government body or agency.

2) Acceptable forms of verification:

a. Displacement by disaster. Verification from a unit or agency of government that an applicant has been or will be displaced as a result of a presidentially declared disaster that results in the uninhabilitability of an applicant's unit.

b. Displacement by government action. Verification from a unit or agency of government that an applicant has been or will be displaced by activity carried on by an agency of the United States or by an State or local government body or agency in connection with code enforcement or a public improvement or development program.

Section 25

IRS Ruling 2004-82 (Q&A)

IRS Revenue Ruling 2004-82

Answering 12 Questions About Low-Income Housing Credit Under I.R.C. Section 42

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Part I

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

Rev. Rul. 2004-82

PURPOSE

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

LAW AND QUESTIONS AND ANSWERS

A. ELIGIBLE BASIS AND QUALIFIED BASIS ISSUES

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

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

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

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

Section 42(d)(4)(C)(i) provides that the adjusted basis of any building located in a qualified census tract is determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation and not otherwise taken into account) used throughout the taxable year in providing any community service facility. Section 42(d)(4)(C)(iii) provides that the term "community service facility" means any facility designed to serve primarily individuals whose income is 60 percent or less of area median income (AMGI) (within the meaning of § 42(g)(1)(B)). Section 42(d)(5)(C)(ii)(I) defines the term "qualified census tract" as any census tract (1) which is designated by the Secretary of Housing and Urban Development (HUD), and (2) for the most recent year for which census data are available on household income in the tract, either in which 50 percent or more of the households have an income which is less than 60 percent of the AMGI for the year or which has a poverty rate of at least 25 percent. See http://www.huduser.org/datasets/qct.html for a listing of census tracts designated by the Secretary of HUD.

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

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

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

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

to the 1954 Code continue to apply except as otherwise modified by the 1986 Act and subsequent law.

Under § 1.1038(b)(4)(i) of the Income Tax Regulations, facilities that are functionally related and subordinate to residential rental projects are considered residential rental property. Section 1.1038(b)(4)(iii) provides that functionally related and subordinate facilities include facilities for use by the tenants, such as swimming pools and other recreational facilities, parking areas, and other facilities reasonably required for the project. Examples in § 1.1038(b)(4)(iii) of facilities reasonably required for a project include units for resident managers or maintenance personnel.

Q-1.
A new qualified low-income building (Building) is located in an area in which owners of apartment buildings typically employ security officers due to the level of crime in the area.

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

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

A-1.
(a) Yes. The legislative history of §42 indicates that residential rental property includes, in addition to the residential rental units, facilities for use by the tenants and other facilities reasonably required by the project.

Under §1.103-8(b)(4)(iii), functionally related and subordinate property is property that is reasonably required for the project. Examples of functionally related and subordinate property are units for resident managers or maintenance personnel. See §1.103-8(b)(4)(iii). Thus, while units for resident managers or maintenance personnel are not residential rental units, they are treated as part of residential rental property because these units are functionally related and subordinate to the project. The unit occupied by a full-time security officer is similar to the units described in the examples contained in § 1.103-8(b)(4)(iii), and is reasonably required by the project because of the level of crime in the area. Thus, the unit is functionally related and subordinate to Building. As a result, the unit is residential rental property for purposes of §42 and its adjusted basis is includable in Building's eligible basis under § 42(d)(1).

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

If in a later year of the credit period, the unit occupied by the full-time

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

Q-2.
A new qualified low-income building (Building) received a housing credit allocation on June 1, 2003, and was placed in service in 2004. Building is located in a qualified census tract (as defined in §42(d)(5)(C)). The neighborhood in which Building is located is an area with a high rate of crime. In 2004, the local police department leases a unit in Building to be used as a police substation (Facility). The Facility is part of the police department's community outreach program. This Facility is intended to serve as a deterrent to crime in the community, assist the community with solving crime-related problems, reduce the response time to area calls for service, and provide the locally assigned police officers with a local office. The services provided by the police are free of charge. The adjusted basis of the property constituting the Facility (of a character subject to the allowance for depreciation and not otherwise taken into account in the adjusted basis of Building) does not exceed 10 percent of the eligible basis of Building.

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

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

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

A-2.
(a) Yes. The Facility qualifies as a community service facility under § 42(d)(4)(C)(iii). Under the facts presented, the Facility is designed to serve primarily individuals whose income is 60 percent or less of AMGI for the following reasons: (1) the services provided at the Facility are services that will help improve the quality of life for community residents; (2) the market study required to be conducted under § 42(m)(1)(A)(iii) found that the services provided at the Facility would be appropriate and helpful to individuals in the area of Building whose income is 60 percent or less of AMGI; (3) the Facility is located within Building; and (4) the services provided at the Facility are affordable to individuals whose income is 60 percent or less of AMGI.

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

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

denominator of Building's applicable fraction.

Q-3.
On applying to the housing credit agency for an allocation of §42 credits for a new building, the housing credit agency requires that the applicant pay a nonrefundable application fee. If the applicant is successful, an allocation fee is payable to the housing credit agency. Are the application fee and allocation fee includable in the eligible basis of the applicant's low-income housing building?

A-3.
No. The application fee and allocation fee are not includable in the eligible basis of the applicant's low-income housing building because the fees are not capitalizable into the adjusted basis of the building. See §263 and §263A. However, depending on the facts and circumstances, all or a portion of these fees may be required to be capitalized as amounts paid to create an intangible asset. See § 1.263(a)-4. Any portion of these fees not required to be capitalized under § 1.263(a)-4 may be deductible as an ordinary and necessary expense under § 162 or § 212, provided the taxpayer satisfies the requirements of those sections.

B. FIRST-YEAR LOW-INCOME UNIT ISSUE

Law

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

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

Section 42(f)(2)(A) provides a special rule for determining the amount of the low-income housing credit allowable for the first year of the credit period. It provides that the credit allowable under §42(a) with respect to any building for the first taxable year of the credit period must be determined by substituting for the applicable fraction under § 42(c)(1) the fraction (i) the numerator of which is the sum of the applicable fractions determined under § 42(c)(1) as of the close of each full month of the first taxable year of the credit period during which the building was in service, and (ii) the denominator of which is 12.

Q-4.
On initial occupancy of a unit in the first year of a newly constructed building's credit period, an income-qualified tenant moved into the unit on the last day of a month. The unit was rent-restricted in accordance with §42(g)(2). In determining the low-income housing credit for the building for the first year of the credit period, is the unit treated as a low-income

unit for that month for purposes of the fraction calculated under §42(f)(2)(A)?

A-4.
Yes. The unit is treated as a low-income unit eligible for inclusion in the numerator and denominator of the monthly applicable fraction calculated under § 42(f)(2)(A)(i) if the tenant, who meets the income limitation under §42(g)(1), resides in the rent-restricted unit on the last day of the month. However, in accordance with § 42(f)(2)(A), the building must have been placed in service for a full month for the unit to be includable in the numerator and denominator of the monthly applicable fraction.

C. EXTENDED LOW-INCOME HOUSING COMMITMENT ISSUE

Law

Section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (as defined in §42(h)(6)(B)) is in effect as of the end of the taxable year. Section 42(h)(6)(B)(i) provides that "the term "extended low-income housing commitment" means any agreement between the taxpayer and the housing credit agency which requires that the applicable fraction (as defined in §42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the agreement and which prohibits the actions described in subclauses (I) and (II) of §42(h)(6)(E)(ii)" (emphasis added).

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

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

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

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

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

Q-5.
Must the extended low-income housing commitment prohibit the actions described in subclauses (I) and (II) of §42(h)(6)(E)(ii) only for the 3-year period described in §42(h)(6)(E)(ii)?

A-5.
No. Section 42(h)(6)(B)(i) requires that an extended low-income housing commitment include a prohibition during the extended use period against (1) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit (no-cause eviction protection) and (2) any increase in the gross rent with respect to the unit not otherwise permitted under §42. When Congress amended §42(h)(6)(B)(i) to add the language emphasized above, §42(h)(6)(E)(ii) was already part of §42. As a result, Congress must have intended the amendment to § 42(h)(6)(B)(i) to add an additional requirement beyond what was contained in § 42(h)(6)(E)(ii), which already prohibited the actions described in that section for the 3 years following the termination of the extended use period. Because the requirements of §42(h)(6)(B)(i) otherwise apply for the extended use period, Congress must have intended the addition of the prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) to apply throughout the extended use period.

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

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

D. HOME INVESTMENT PARTNERSHIP ACT LOAN ISSUES

Law

Section 42(b)(2)(A) provides that for a qualified low-income building placed in service by the taxpayer after 1987, the term "applicable percentage"

means (1) the 70-percent present value credit under §42(b)(2)(B)(i) for new buildings which are not federally subsidized, and (2) the 30-percent present value credit under §42(b)(2)(B)(ii) for new buildings which are federally subsidized and for existing buildings.

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

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

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

Section 42(g)(2)(C) provides that the imputed income limitation applicable to a unit is the income limitation which would apply under §42(g)(1) to individuals occupying the unit if the number of individuals occupying the unit were: (i) in the case of a unit which does not have a separate bedroom, 1 individual; and (ii) in the case of a unit which has one or more separate bedrooms, 1.5 individuals for each separate bedroom.

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

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

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

Section 42(i)(2)(C) provides that §42(i)(2)(A) will not apply to any tax-exempt obligation or below market Federal loan used to provide

construction financing for any building if (i) the obligation or loan (when issued or made) identified the building for which the proceeds of the obligation or loan would be used, and (ii) the obligation is redeemed, and the loan is repaid, before the building is placed in service.

Section 42(i)(2)(D) provides that the term "below market Federal loan" means any loan funded in whole or in part with Federal funds if the interest rate payable on the loan is less than the applicable Federal rate (AFR) in effect under §1274(d)(1) (as of the date the loan was made).

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

Q-6.
Taxpayer owns a new qualified low-income housing project consisting of Buildings 1 and 2, each containing 100 residential rental units. Forty percent of the units in each building are low-income units. Taxpayer elected the minimum set-aside for the project under §42(g)(1)(B). Also, Taxpayer elected on Form 8609, Low-Income Housing Credit Allocation Certification, to treat the buildings as part of a multiple building project. A HOME loan at less than the AFR was provided with respect to the project.

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

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

A-6.
(a) To qualify the project for the 70-percent present value credit, Taxpayer must rent at least 40 units in each of Buildings 1 and 2 to tenants whose income is 50 percent or less of AMGI throughout the 15-year compliance period because the rule under §42(i)(2)(E)(i) applies on a building-by-building basis. Because these units are to be low-income units and Taxpayer elected the minimum set-aside under § 42(g)(1)(B), the same units used to satisfy the special set-aside under §42(i)(2)(E)(i) will also satisfy the project's minimum set-aside.

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

Q-7.
(a) Taxpayer owns a newly constructed qualified low-income housing project consisting of one building located in a qualified census tract (Building). A HOME loan at less than the AFR was provided with respect to Building.

Construction of Building was funded in part with an obligation the interest on which is exempt from tax under §103 that was outstanding after Building was placed in service. Taxpayer did not elect to exclude from eligible basis the principal amount of the HOME loan or the proceeds of the tax-exempt obligation as provided under §42(i)(2)(B). Forty percent of the residential units in Building are occupied by individuals whose income is 50 percent or less of area median gross income. Is Building eligible for the increase in eligible basis provided under §42(d)(5)(C)(i)(I)?

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

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

A-7.
(a) Yes. Because the tax-exempt obligation is outstanding after Building was placed in service and the proceeds of the obligation were not excluded from Building's eligible basis under §42(i)(2)(B), Building is treated as federally subsidized under § 42(i)(2)(A). Inasmuch as the building is treated as federally subsidized, the 30-percent present value credit under §42(b) will apply to Building. The fact that the tax-exempt obligation caused Building to be federally subsidized makes §42(i)(2)(E)(i) (which provides that certain HOME loans will not cause a project to be federally subsidized if the special set-aside requirement under that section is satisfied, and whose applicability prohibits the increase in eligible basis under §42(d)(5)(C)) inapplicable. Accordingly, Building is eligible for the increase in eligible basis under § 42(d)(5)(C)(i)(I).

If the tax-exempt obligation was redeemed before Building was placed in service or the proceeds of the obligation were excluded from Building's eligible basis, Building would no longer be treated as federally subsidized by the tax-exempt obligation under § 42(i)(2)(A). Therefore, §42(i)(2)(E)(i) would be applicable, and cause Building not to be treated as federally subsidized by the HOME loan under §42(i)(2)(A). Accordingly, the prohibition in §42(i)(2)(E)(i) against using §42(d)(5)(C) would apply, and Building would not be eligible for the increase in eligible basis under §42(d)(5)(C)(i)(I). The 70-percent value credit under §42(b) would apply to Building.

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

(c) Yes. Although Building meets the exception under §42(i)(2)(C) with respect to the tax-exempt obligation, Building is treated as federally

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

If Taxpayer elected to exclude the principal amount of the HOME loan from the eligible basis of Building under §42(i)(2)(B) (whether or not the special set-aside under § 42(i)(2)(E)(i) was met), Building would not be treated as federally subsidized under § 42(i)(2)(A), and the 70-percent present value credit would apply to Building. Because the HOME loan would not be taken into account, §42(i)(2)(D) and §42(i)(2)(E)(i) do not apply to Building. Therefore, Building would not be described in §42(i)(2)(E)(i). Accordingly, the prohibition in §42(i)(2)(E)(i) against using §42(d)(5)(C) would not apply, and Building would be eligible for the increase in eligible basis under § 42(d)(5)(C)(i)(I).

E. VACANT UNIT RULE ISSUES

Law

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

The legislative history to §42 indicates that vacant units, formerly occupied by low-income individuals, may continue to be treated as occupied by qualified low-income individuals for purposes of the minimum set-aside requirement (as well as for determining qualified basis) provided reasonable attempts are made to rent the unit. H.R. Conf. Rep. No. 841, supra, at II-94.

Section 42(g)(2)(D)(i) provides that notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under § 42(g)(1), the unit will continue to be treated as a low-income unit if the income of the occupants initially met the income limitation and the unit continues to be rent-restricted. Section 42(g)(2)(D)(ii) provides that if the income of the occupants of the unit increases above 140 percent of the income limitation applicable under §42(g)(1), the unit ceases to be treated as a low-income unit if any available or subsequently available residential rental unit in the building (of a size comparable to, or smaller than, the unit) is occupied by a new resident whose income exceeds the income limitation (the "available unit rule").

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

Section 1.42-15(c) provides that a unit is not available for purposes of the

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

Q-8.
On July 1, 2003, an income-qualified household (Household) initially occupied a rent-restricted residential rental unit in Building 1 of Project. On October 31, 2003, the property manager moved Household (and transferred Household's lease) to a similar rent-restricted unit in Building 2 of Project that was not previously occupied. Household occupied the Building 2 unit at the end of 2003. The unit Household vacated in Building 1 was unoccupied during November and December. Are both units in Buildings 1 and 2 low-income units at the end of 2003?

A-8.
No. While a vacant low-income unit generally retains its character as a low-income unit, where an owner simply moves a tenant from a unit in one building to a unit in another building in the same project, both units may not be treated as low-income units; rather, only the unit that the tenant actually occupies at the end of a month in the first year of the credit period and at the end of each year in subsequent years qualifies as a low-income unit. Thus, in this situation, while the unit in Building 1 vacated by Household was treated as a low-income unit during the months it was occupied by Household, the unit ceased to be treated as a low-income unit when Household vacated the unit. At that time, the vacated unit would be treated as a unit not previously occupied.

Q-9.
Ten units previously occupied by income-qualified tenants in a 200-unit mixed-use housing project are vacant. None of the low-income units in the project had been over-income units. The project owner displayed a banner and for rent signs at the entrance to the project, placed classified advertisements in two local newspapers, and contacted prospective low-income tenants on a waiting list for the project and on a local public housing authority list of section 8 voucher holders about the low-income unit vacancies. These are customary methods of advertising apartment vacancies in the area of the project for identifying prospective tenants. Subsequent to the low-income unit vacancies, a market-rate unit of comparable size to the low-income units became vacant. Will the owner violate the vacant unit rule if the owner rents the market-rate unit before any of the low-income units?

A-9.
No. In accordance with §1.42-5(c)(1)(ix), the owner of a qualified low-income housing project has to use reasonable attempts to rent a vacant low-income unit or the next available unit of comparable or smaller size to tenants having a qualifying income before any units in the project are rented to tenants not having a qualifying income. Thus, if the project owner makes reasonable attempts to rent the vacant low-income units to income-qualified tenants, the owner may rent the newly vacated market-rate unit before renting the low-income units and continue to characterize the vacant low-income units as low-income units for purposes of the minimum set-aside requirements in §42(g)(1) and calculation of the applicable fraction under § 42(c)(1)(B).

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

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

Q-10.
A building has 10 units of comparable size, consisting of 7 low-income units (none was an over-income unit) and 3 market-rate units. All units in the building were occupied except for one market-rate unit. A low-income unit became vacant on March 15, 2004. Between March 15, 2004, and March 29, 2004, the owner made reasonable attempts to rent this unit to an income-qualified tenant. The vacant low-income unit became subject to a reservation (a contractual arrangement that is binding on the building owner under local law prior to the date a lease is signed or the unit is occupied) on March 29, 2004, under which the owner agreed to rent the unit to A, whose income meets the income limitation elected for the project under §42(g)(1). Thereafter, the owner ceased any efforts to attempt to rent the unit. On April 30, 2004, A signed a lease for the unit and occupied the unit on May 1, 2004. The vacant market-rate unit was rented to a market-rate tenant on April 15, 2004. Did the owner violate the vacant unit rule?

A-10.
No. For purposes of the vacant unit rule, an owner needs to make reasonable attempts to rent an available vacant low-income unit. To determine what constitutes an available unit for purposes of the vacant unit rule, the Internal Revenue Service will adopt the rule under §1.42-15(c) for when a unit is considered not available. Therefore, a unit is not available for purposes of the vacant unit rule when the unit is no longer available for rent due to contractual arrangements that are binding under local law, such as a reservation entered into between a building owner and a prospective tenant. Thus, in this situation, because the vacant low-income unit was subject to a reservation that was binding under local law prior to the renting of the vacant market-rate unit, the low-income unit was not available when the market-rate unit was rented. Accordingly, the owner no longer needed to make reasonable efforts to rent the low-income unit.

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

F. RECORDKEEPING AND RECORD RETENTION ISSUE

Law

Section 42(m)(1)(A)(i) requires each housing credit agency to allocate low-income housing credits according to a qualified allocation plan. Under § 42(m)(1)(B)(iii), an allocation plan is not qualified unless it contains a procedure that the housing credit agency (or an agent or other private contractor of the agency) will follow in (1) monitoring for noncompliance

with the provisions of § 42, (2) notifying the Service of any noncompliance which the agency becomes aware of, and (3) monitoring for noncompliance with habitability standards through regular site visits.

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

Section 1.42-5(b)(1) provides that a housing credit agency must require the owner of a low-income housing project to keep certain specified records for each qualified low-income building in the project for each year in the compliance period. Under §1.425(b)(2), the owner must be required to retain the records described in § 1.42-5(b)(1) for a particular year for at least 6 years after the due date (with extensions) for filing the Federal income tax return for that year. The records for the first year of the credit period, however, must be retained for at least 6 years beyond the due date (with extensions) for filing the Federal income tax return for the last year of the compliance period (as defined in §42(i)(1)) of the building. Section 1.42-5(b)(3) also specifies that the owner must be required to retain the original local health, safety, or building code violation reports or notices that were issued by the state or local government unit (as described in § 1.425(c)(1)(vi)) for inspection by the housing credit agency.

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

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

Q-11.
May a taxpayer comply with the recordkeeping and record retention provisions under § 1.425(b) by using an electronic storage system instead of maintaining hardcopy (paper) books and records?

A-11.

Yes, provided that the electronic storage system satisfies the requirements of Rev. Proc. 97-22. However, complying with the recordkeeping and record retention requirements of the Service does not exempt an owner from having to satisfy any additional recordkeeping and record retention requirements of the monitoring procedure adopted by the housing credit agency. For example, the housing credit agency may require the taxpayer to maintain hardcopy books and records.

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

G. TENANT INCOME DOCUMENTATION ISSUE

Law

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

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

Rev. Proc. 94-65, 1994-2 C.B. 798, indicates that an owner may satisfy the documentation requirement of §1.42-5(b)(1)(vii) for a low-income tenant's income from assets by obtaining a signed, sworn statement from the tenant or prospective tenant if (1) the tenant's or prospective tenant's Net Family assets do not exceed $5,000, and (2) the tenant or prospective tenant provides a signed, sworn statement to this effect to the building owner. The revenue procedure provides that a housing credit agency's monitoring procedure may not permit an owner to rely on a low-income tenant's signed, sworn statement of annual income from assets if a reasonable person in the owner's position would conclude that the tenant's income is higher than the tenant's represented annual income. In this case, the owner must obtain other documentation of the low-income tenant's income from assets to satisfy the documentation requirement. In addition, the revenue procedure indicates that a housing credit agency's monitoring procedure may continue to require that an owner obtain documentation, other than the signed, sworn statement, to support a low-income tenant's annual certification of income from assets.

Q-12.
On reviewing tenant files of a project, the housing credit agency discovered that for purposes of determining the income of certain tenants, the owner had accepted signed, sworn self-certifications in which the tenants stated that they had not received any child support payments. Is a signed, sworn self-certification by a tenant sufficient documentation under §1.42-5(b)(1)(vii) to show that the tenant is not receiving child support payments?

A-12.
Yes. Consistent with the documentation requirements in Rev. Proc. 94-65, a signed, sworn self-certification by a tenant is sufficient documentation under § 1.42-5(b)(1)(vii) to show that a tenant is not receiving child support payments. In addition to specifying that a tenant is not receiving any child support payments, an annual signed, sworn self-certification should indicate whether the tenant will be seeking or expects to receive child support payments within the next 12 months. If the tenant possesses a child support agreement but is not presently receiving any child support payments, the tenant should include an explanation of this and all supporting documentation such as a divorce decree and court documents to enforce payment. Also, the self-certification should indicate that the tenant will notify the owner of any changes in the status of child support.

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

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

DRAFTING INFORMATION

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

Section 26

Compliance Monitoring

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.

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

Proposed Rules

Federal Register
Vol. 85, No. 130
Tuesday, July 7, 2020

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–123027–19]

RIN 1545–BP59

Section 42, Low-Income Housing Credit Compliance-Monitoring Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the compliance-monitoring duties of State or local housing credit agencies (Agencies) for purposes of the low-income housing credit under section 42 of the Internal Revenue Code (Code). These proposed regulations would relax the minimum compliance-monitoring sampling requirement for purposes of physical inspections and low-income certification review provided in the Amendments to the Low-Income Housing Credit Compliance-Monitoring Regulations (T.D. 9848) published in the **Federal Register** (84 FR 6076). The proposed regulations will affect owners of low-income housing projects, tenants in those low-income housing projects, and Agencies that administer the credit.

DATES: Written or electronic comments and requests for a public hearing must be received by September 8, 2020.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–123027–19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

Send paper submissions to: CC:PA:LPD:PR (REG–123027–19), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Dillon Taylor or Michael J. Torruella Costa at (202) 317–4137; concerning submissions of comments and/or requests for a public hearing, Regina Johnson, (202) 317–5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 42 of the Code.

Section 42(m)(1) requires an Agency to allocate housing credit dollar amounts (the potential to earn low-income housing credits) among candidate proposed buildings/projects. The allocation must be pursuant to a qualified allocation plan (QAP) that has been approved by the governmental unit of which the Agency is a part. A QAP not only sets forth selection criteria by which an Agency makes these allocations but also provides a procedure that the Agency must follow in monitoring for noncompliance with the provisions of section 42, including monitoring for noncompliance with habitability standards through regular site visits.

Section 1.42–5 of the Income Tax Regulations (the compliance-monitoring regulations) provides the requirements of a monitoring procedure that must be part of any QAP. Among the requirements, an Agency must perform physical inspections and low-income certification review.

The compliance-monitoring regulations, however, do not require that *every* low-income unit in a project be monitored for non-compliance. Instead, Agencies are permitted to satisfy their compliance-monitoring duties by physically inspecting, and performing low-income certification review, on only samples of those units. *See* T.D. 8430, 57 FR 40118, 40121 (Sept. 2, 1992).[1] For many years, starting in 2000, the minimum sample size for both file review and on-site inspections was 20 percent of the low-income units, regardless of the size of the total population of low-income units in a project. *See* TD 8859, 65 FR 2323, 2327 (Jan. 14, 2000).

On February 25, 2016, the Treasury Department and the IRS published temporary regulations (T.D. 9753) in the **Federal Register** (81 FR 9333), which amended § 1.42–5 of the Income Tax Regulations and permitted the IRS to establish sample-size criteria in guidance published in the Internal Revenue Bulletin. *See* § 601.601(d)(2)(ii)(b) of 26 CFR Chapter 1.[2] Concurrently with the issuance of the temporary regulations, Revenue Procedure 2016–15, 2016–11 I.R.B. 435, was published in the Internal Revenue Bulletin. This revenue procedure permitted an Agency to elect to use sample sizes of either a minimum of 20 percent of the low-income units in a project (rounded up to the nearest whole number) or the number in a chart identifying minimum sample sizes depending on the number of low-income units in a project (the Low-Income Housing Credit Minimum Unit Sample Size Reference Chart). The minimum sample sizes in the chart correspond to the minimum sample sizes required by the Department of Housing and Urban Development's (HUD's) Real Estate Assessment Center for inspections under HUD programs (the REAC numbers). HUD designed this table of sample sizes to produce a statistically consistent level of confidence in the results of physical inspections across a broad range of project sizes.

[1] Initially, the requirements were that the Agency choose which units receive low-income certification review, that the owner receive no more than reasonable notice of the review, and that the Agency have the right to perform on-site inspection. *See* TD 8430 at 40122–23. Subsequently, some on-site inspections were required, and samples for both review and inspection were required to be chosen randomly. *See* TD 8859, 65 FR 2323, 2327 (Jan. 14, 2000).

[2] Also in the same issue of the **Federal Register**, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–150349–12, 81 FR 9379) (proposed regulations). The text of the proposed regulations incorporated by cross-reference the text of the temporary regulations.

The revenue procedure had the effect of reducing the minimum sample sizes for large low-income housing projects (those with more than 110 low-income units). Because of the choice between using the REAC number and 20 percent of the low-income units, the revenue procedure did not impact projects with fewer than 111 low-income units.

The same sample-size provisions applied to independently selected samples on which the Agency must perform low-income certification review. The revenue procedure provided only minimum sample sizes, permitting Agencies to monitor compliance in more units, if desired.

In the preamble to the temporary regulations, the Treasury Department and the IRS expressed concern that, in smaller projects, physical inspection or low-income certification review of only 20 percent of the units might fail to produce sufficiently accurate estimates of the remaining units' overall compliance with habitability and low-income certification. To address this concern, the preamble added that ''the Treasury Department and the IRS intend to consider whether Rev. Proc. 2016–15 should be replaced with a revenue procedure that does not permit use of the 20 percent rule in those circumstances.'' 81 FR at 9334. The removal of the 20 percent option would generally increase the number of units that needed to be inspected in smaller projects. The public comments on the temporary regulations directed very little attention to this potential increase.

In addition, the preamble invited fundamental suggestions to make inspections less burdensome:

> The Treasury Department and the IRS believe the methods in Rev. Proc. 2016–15 reasonably balance the burden on Agencies, tenants, and building owners while adequately monitoring compliance. However, additional comments may be submitted on other possible methods, including stratified sampling procedures and estimation methodologies. To be useful, any such comments should include substantial detail regarding the procedures to be adopted and should provide thorough justification as to whether the suggested methods effectively reduce burden without negatively impacting the confidence that can be placed in the results obtained from the resulting samples.

Id. at 9336. The public submitted no comment letters specifically responsive to this request.

On February 26, 2019, the Treasury Department and IRS published regulations (T.D. 9848) in the **Federal Register** (84 FR 6076), finalizing the temporary regulations. Because these final regulations contain provisions directly addressing all issues previously addressed in Revenue Procedure 2016–15, the preamble of the final regulations declares that revenue procedure obsolete with respect to an Agency as of the date on which the Agency's QAP is amended to reflect the final regulations and, in all cases, after December 31, 2020. *See* 84 FR at 6078. Among other provisions, the final regulations require Agencies to inspect no fewer units than the number specified for projects of the relevant size in the REAC numbers. This requirement has the effect of increasing the sample sizes for smaller projects. The Treasury Department and the IRS determined that the REAC numbers produce a statistically valid sampling of units and that using them yielded a consistent level of confidence in the compliance-monitoring results for projects of various sizes. The final regulations allow Agencies a reasonable period of time to amend their QAPs for this purpose, but require QAPs to be amended no later than December 31, 2020.

Since the publication of the final regulations, the Treasury Department and the IRS have received numerous oral and written comments from Agencies, stakeholders, and trade groups representing Agencies. In particular, these comments expressed concern that the final regulations ended Agencies' ability to use samples of 20 percent of the low-income units in a project when the applicable REAC number is larger. Consistent with the comments and letters, the trade groups' comment letters expressed concern about the situations in which the REAC numbers would increase the number of units that Agencies must examine, thereby increasing Agencies' costs for additional staff and other related expenditures and burdens. One trade group further explained that many Agencies would encounter difficulty in addressing increased staffing needs and other new costs due to overall State budget constraints. The trade group observed that cost increases are also likely to cause Agencies to increase the compliance-monitoring fees that they charge to building owners. If fees are not increased enough to cover the increased costs, Agencies will have to divert resources from other affordable housing priorities to fund their compliance-monitoring activities. The trade group noted that terminating the ability to use the 20 percent samples will have its most significant impact on States with numerous small projects, predominantly in rural areas, and that some States with only small projects may even experience a 100 percent increase in burden.

Explanation of Provisions

The final regulations reflected the belief of the Treasury Department and the IRS that a higher compliance-monitoring burden on Agencies was justified by the increased statistical confidence that results from the use of the REAC numbers to determine sample sizes for smaller projects. The comments on the final regulations, however, have demonstrated the magnitude of the increased costs and burdens that this requirement imposes on Agencies. As a result of these comments, the Treasury Department and the IRS have greater awareness of the many practical challenges Agencies experience in using samples greater than 20 percent while carrying out their compliance-monitoring responsibilities. Furthermore, the comments noted that many Agencies typically evaluate each project to determine if circumstances warrant the inspection and review of more units than the required minimum. Complying with the REAC numbers when an Agency believes that smaller samples would be sufficient may have the effect of depriving the Agency of the resources that it requires to engage in additional compliance-monitoring activities on projects that manifest the need for inspection and review of more than the minimum sample of units.

Although there is value in providing a level of confidence that is more consistent over a broad range of project sizes, that increased consistency is outweighed in this context by concerns over Agencies' compliance-monitoring burdens. One goal of the compliance-monitoring regulations is to increase flexibility and reduce burden, so that Agencies may fulfill their compliance-monitoring responsibilities in an efficient and cost-effective manner. Accordingly, the Treasury Department and the IRS propose returning to the sample-size requirements that applied under the temporary regulations. Thus, under these proposed regulations, the minimum number of low-income units that must be included in the random samples on which an Agency conducts physical inspections or low-income certification review is the lesser of the applicable REAC number or 20 percent of the low-income units in the project, rounded up to the next whole number.

Proposed Applicability Date

These regulations are proposed to apply beginning after the date these regulations are published as final regulations in the **Federal Register**. However, an Agency may rely on these proposed regulations beginning on February 26, 2019, until December 31 of

the calendar year following the year that contains the date these regulations are published as final regulations in the **Federal Register**.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

In accordance with the Regulatory Flexibility Act (5 U.S.C. chapter 6) it is hereby certified that these regulations will not impose a significant economic impact on a substantial number of small entities. These regulations reinstate the minimum compliance-monitoring sampling requirement for purposes of physical inspections and low-income certification review previously provided under the temporary regulations (T.D. 9753) published in the **Federal Register** (81 FR 9333) on February 25, 2016. These previously provided requirements had been and continue to be relied upon by Agencies since 2016.

Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020–4, 2020–17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal authors of these regulations are Dillon Taylor and Michael J. Torruella Costa, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

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

■ **Par. 2.** Amend § 1.42–5 by revising paragraphs (c)(2)(iii)(B) and (h) to read as follows:

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

* * * * *

(c) * * *

(2) * * *

(iii) * * *

(B) *Number of low-income units.* The minimum number of low-income units for which the Agency must conduct on-site inspections and low-income certification review is the lesser of—

(*1*) 20 percent of the low-income units in the low-income housing project, rounded up to the nearest whole number of units; or

(*2*) the Minimum Unit Sample Size set forth in the following Low-Income Housing Credit Minimum Unit Sample Size Reference Chart:

TABLE 1 TO PARAGRAPH (c)(2)(iii)

Number of low-income units in the low-income housing project	Number of low-income units selected for inspection or for low-income certification review (minimum unit sample size)
1	1
2	2
3	3
4	4
5–6	5
7	6
8–9	7
10–11	8
12–13	9
14–16	10
17–18	11
19–21	12
22–25	13
26–29	14
30–34	15
35–40	16
41–47	17
48–56	18
57–67	19
68–81	20
82–101	21
102–130	22
131–175	23
176–257	24
258–449	25
450–1,461	26
1,462–9,999	27

* * * * *

(h) *Applicability dates.* The requirements in paragraph (c)(2)(iii)(B) of this section apply beginning after the date final regulations are published in the **Federal Register**.

Douglas W. O'Donnell,

Acting Deputy Commissioner for Services and Enforcement.

[FR Doc. 2020–14555 Filed 7–2–20; 4:15 pm]

BILLING CODE 4830–01–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 100

[Docket Number USCG–2020–0348]

RIN 1625–AA08

Special Local Regulation; Ohio River, Owensboro, KY

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard is proposing to establish a temporary special local regulation for all navigable waters of the Ohio River from mile marker (MM) 754 .0 to MM 759.0. This action is necessary to provide for the safety of life on these navigable waters near Owensboro, KY, during a high speed boat race on August 14, 2020 through August 16, 2020. This proposed rulemaking would prohibit persons and vessels from being in the regulated area unless authorized by the

Section 27

December 2007
Student Exception Change
(Single Parent Rule)

Excerpt from H.R. 3648: Mortgage Forgiveness Debt Relief Act of 2007 (enacted 12/07)

SEC. 6. CLARIFICATION OF STUDENT HOUSING ELIGIBLE FOR LOW-INCOME HOUSING CREDIT.

(a) In General- Subclause (I) of section 42(i)(3)(D)(ii) of the Internal Revenue Code of 1986 (relating to certain students not to disqualify unit) is amended to read as follows:

> `(I) single parents and their children and such parents are not dependents (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof) of another individual and such children are not dependents (as so defined) of another individual other than a parent of such children, or.'.

(b) Effective Date- The amendment made by this section shall apply to--

(1) housing credit amounts allocated before, on, or after the date of the enactment of this Act, and

(2) buildings placed in service before, on, or after such date to the extent paragraph (1) of section 42(h) of the Internal Revenue Code of 1986 does not apply to any building by reason of paragraph (4) thereof.

Section 28

Internal Revenue Bulletin 2008-39

(Utility allowance final regulations)

Internal Revenue
bulletin

Bulletin No. 2008-39
September 29, 2008

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2008–47, page 760.

Interest rates; underpayments and overpayments. The rates of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 2008, will be 6 percent for overpayments (5 percent in the case of a corporation), 6 percent for underpayments, and 8 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 3.5 percent.

T.D. 9420, page 750.

Final regulations under section 42 of the Code, concerning the low-income housing tax credit, update the utility allowances regulations to provide new options for estimating tenant utility costs.

REG–120844–07, page 770.

Proposed regulations under section 460 of the Code would amend the regulations as they apply to certain long-term construction contracts that qualify as home construction contracts under section 460(e)(6) and to certain changes in method of accounting for long-term contracts. A public hearing is scheduled for December 5, 2008.

REG–106251–08, page 774.

Proposed regulations under section 423 of the Code provide the requirements that must be satisfied in order for a plan to meet the definition of an employee stock purchase plan. Section 423 also addresses the individual income tax treatment of stock acquired pursuant to an option granted under an employee stock purchase plan. The regulations update the existing regulations and provide additional guidance in certain areas.

Notice 2008–76, page 768.

This notice addresses the application of section 382 of the Code in the case of certain acquisitions made pursuant to the Housing and Economic Recovery Act of 2008.

EMPLOYEE PLANS

REG–106251–08, page 774.

Proposed regulations under section 423 of the Code provide the requirements that must be satisfied in order for a plan to meet the definition of an employee stock purchase plan. Section 423 also addresses the individual income tax treatment of stock acquired pursuant to an option granted under an employee stock purchase plan. The regulations update the existing regulations and provide additional guidance in certain areas.

EXEMPT ORGANIZATIONS

Rev. Proc. 2008–55, page 768.

This procedure provides guidance with respect to the classification of Indian tribal entities that the Service recognizes as Indian Tribal Governments under sections 7701(a)(40) and 7871 of the Code. The procedure has been coordinated with a list of federally recognized tribes published by the Department of Interior, Bureau of Indian Affairs. Rev. Proc. 2002–64 superseded.

(Continued on the next page)

Finding Lists begin on page ii.
Index for July through September begins on page v.

Department of the Treasury
Internal Revenue Service

ESTATE TAX

T.D. 9421, page 755.

Final regulations under section 2642(a)(3) of the Code provide guidance regarding the generation-skipping transfer (GST) tax consequences of the severance of a trust in a manner that is effective under state law, but that does not meet the requirements of a qualified severance under section 2642(a)(3). The regulations also provide guidance regarding the GST tax consequences of a qualified severance of a trust with an inclusion ratio between zero and one into more than two resulting trusts. In addition, the regulations provide special funding rules applicable to the non-*pro rata* division of certain assets between or among resulting trusts.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

26 CFR 1.42–10: Utility allowances.

T.D. 9420

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Section 42 Utility Allowance Regulations Update

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations that amend the utility allowances regulations concerning the low-income housing tax credit. The final regulations update the utility allowance regulations to provide new options for estimating tenant utility costs. The final regulations affect owners of low-income housing projects who claim the credit, the tenants in those low-income housing projects, and the State and local housing credit agencies that administer the credit.

DATES: *Effective Date:* These regulations are effective July 29, 2008.

Applicability Date: For dates of applicability, see §1.42–12(a)(4).

FOR FURTHER INFORMATION CONTACT: David Selig (202) 622–3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) relating to the low-income housing credit under section 42 of the Internal Revenue Code (Code). On June 19, 2007, the IRS and Treasury Department published in the **Federal Register** proposed regulations under section 42(g)(2)(B)(ii) (REG–128274–03, 2007–33 I.R.B. 356 [72 FR 33703]). Written and electronic comments responding to the proposed regulations were received and a public hearing was held on the proposed regulations on October 9, 2007. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision.

General Overview

Section 42(a) provides that, for purposes of section 38, the amount of the low-income housing credit determined under section 42 for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building. A qualified low-income building is defined in section 42(c)(2) as any building that is part of a qualified low-income housing project.

A qualified low-income housing project is defined in section 42(g)(1) as any project for residential rental property if the project meets one of the following tests elected by the taxpayer: (1) at least 20 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income; or (2) at least 40 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income. If a taxpayer does not meet the elected test, the project is not eligible for the section 42 credit.

Under section 42(g)(4), section 142(d)(2)(B) applies when determining whether any project is a qualified low-income housing project under section 42(g)(1). Section 142(d)(2)(B) provides that the income of individuals and area median gross income is determined by the Secretary in a manner consistent with determinations of lower income families and area median gross income under section 8 of the United States Housing Act of 1937. Under Rev. Rul. 94–57, 1994–2 C.B. 5, taxpayers may rely on a list of income limits released by the Department of Housing and Urban Development (HUD) until 45 days after HUD releases a new list of income limits, or until HUD's effective date for the new list, whichever is later.

In order to qualify as a rent-restricted unit within the meaning of section 42(g)(2), the gross rent for the unit must not exceed 30 percent of the imputed income limitation applicable to the unit. Section 42(g)(2)(B)(ii) requires the inclusion in gross rent of a utility allowance determined by the Secretary after taking into account the determinations under section 8 of the United States Housing Act of 1937.

Section 1.42–10(a) provides that if utility costs (other than telephone) for a residential rental unit are paid directly by the tenant, then the gross rent for that unit includes the applicable utility allowance as determined under § 1.42–10. Section 1.42–10(b) provides rules for calculating the appropriate utility allowance based upon whether (1) the building receives rental assistance from the Farmers Home Administration (FmHA), now known as the Rural Housing Service; (2) the building has any tenant that receives FmHA rental assistance; (3) the building is not described in (1) or (2) above and the building's rents and utility allowances are reviewed by HUD on an annual basis; or (4) the building is not described in (1), (2), or (3) above (other buildings).

Currently, under §1.42–10(b)(4), other buildings generally use the applicable Public Housing Authority (PHA) utility allowance established for the Section 8 Existing Housing Program or use a local utility company estimate. The local utility company estimate may be obtained by any interested party (including a low-income tenant, a building owner, or a State or local housing credit agency (Agency)).

The proposed regulations proposed two additional options for calculating utility allowances. The first option would permit a building owner to obtain a utility estimate for each unit in a building from the Agency that has jurisdiction over the building (the Agency estimate). The Agency estimate must take into account the local utility rates data, property type, climate variables by region in the State, taxes and fees on utility charges,

and property building materials and mechanical systems. An Agency may also use actual utility company usage data and rates for the building. The second option would permit a building owner to calculate utility allowances using the "HUD Utility Schedule Model" found on the Low-Income Housing Tax Credits page at *www.huduser.org/datasets/lihtc.html* (or successor URL). The HUD Utility Schedule Model is based on data from the Residential Energy Consumption Survey (RECS) conducted by the Department of Energy. RECS data provides energy consumption by structure for heating, air conditioning, cooking, water heating, and other electric (lighting and refrigeration). The HUD Utility Schedule Model incorporates building location and climate.

Summary of Comments and Explanation of Changes

Exclusions from utility allowance

Prior to these final regulations, §1.42–10(a) provided for the exclusion of telephone costs in determining the amount of the utility allowance to be included in gross rent. The proposed regulations excluded cable television costs as well as telephone costs. The final regulations retain the exclusions for cable television and telephone costs and also exclude Internet costs. The IRS and Treasury Department believe it is appropriate to exclude cable television and Internet costs as comparable to telephone costs.

Additional option for determining utility allowances

Commentators stated that the Agency estimate in the proposed regulations may be administratively burdensome for some Agencies. As an alternative, commentators suggested adding an option that would allow utility estimates to be calculated by a state-certified engineer or other qualified professional. The commentators specified that, under this option, computer software could be developed that would estimate the energy or water and sanitary sewer service cost for each type of unit in a building. The estimates would be determined based on the applicable current local utility billing rate schedule and would be applied to all comparable units in the building using specific information about the design, materials, equipment, and location of the building.

A computer software model that incorporates specific information about the design and location of the building for which the utility allowances are being developed, and that can be updated with actual consumption data and with consumption estimates as new efficiency measures and improvements are undertaken, would provide more accurate estimates of utility consumption. Therefore, the final regulations also include a new option allowing building owners to retain the services of a qualified professional to calculate utility allowances based on an energy consumption model.

The use of this new option is subject to several special rules. First, 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. Second, the utility estimates must be calculated by either (1) a properly licensed engineer or (2) a qualified professional approved by the Agency that has jurisdiction over the building (together, qualified professional). The qualified professional and the building owner must not be related within the meaning of section 267(b) or 707(b). Third, the building owner must furnish a copy of the estimates derived from the energy consumption model to the Agency and make copies of the estimates available to all tenants in the building. Finally, the building owner must pay for all costs incurred in obtaining the utility estimates from the qualified professional and providing the estimates to the Agency and tenants.

Default option/option ordering

One commentator suggested that the final regulations should provide a default option because, in the absence of a definitive standard for determining utility allowances, building owners would use the option that yields the lowest utility estimates. Commentators further requested clarification as to which option should be used when multiple options are available, whether building owners may use different options for different utilities, and whether owners may change the options used for calculating utilities from time to time.

An energy consumption model developed by a qualified professional that takes into account specific information about the design and location of the building for which the utility allowances are being developed should produce the most accurate utility estimates. It is expected that this more accurate model will be the model most commonly used by most building owners, particularly those with buildings that are not very old. However, if a building owner selects an option that yields higher utility allowances, the building owner should be free to accept a lower amount of rent from tenants. Therefore, there is no need for a stated default option or option ordering rule. Further, the final regulations neither prohibit using different options for different utilities nor prohibit changing the options used for calculating utilities. If an Agency determines that a building owner has understated the utility allowances for the building under the particular option chosen by the owner for calculating the utility allowance, and the building's units are not rent-restricted units under section 42(g)(2) as a result, the Agency must report the noncompliance on Form 8823, *Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition*.

Application of newly calculated utility allowances

Under current §1.42–10(c) of the regulations, if the applicable utility allowance for units changes, the new utility allowance must be used to compute gross rent of rent-restricted units due 90 days after the change (the 90-day period). The proposed regulations limited the effective date of any new utility allowances to the earlier of the date 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. The proposed regulations also modified §1.42–10(c) by requiring that a building owner must review at least annually the basis on which utility allowances have been established and must update the applicable utility allowance. 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.

Commentators suggested that building owners should be obligated to adjust utility allowances when utility rates increase by a stated percentage, for example, 10 percent, which is the rule for revising utility allowance schedules for PHAs under 24 CFR 982.517(c). This HUD rule provides that a PHA must review its schedule of utility allowances each year and revise its allowance for a utility category if the utility rate has changed by 10 percent or more since the utility allowance schedule was last revised. The commentators did not address decreases in utility rates. A commentator also suggested that the final regulations should require an Agency to review or have owners review local utility rates quarterly to determine if rates have increased sufficiently to require an adjustment. A different commentator suggested limiting reviews to no more than once per year.

The IRS and Treasury Department do not believe that fluctuations in utility rates within a given year should trigger recalculations of utility allowances more than once a year. The IRS and Treasury Department do not believe that the additional burden of updating the utility allowances more than once a year is warranted at this time. Utility rates generally do not change more than once a year, and yearly updated utility allowances would reflect average rates applicable to all tenants in a building from year to year. Therefore, the final regulations require building owners to calculate new utility allowances once during the calendar year regardless of any percentage change in utility rates. Building owners may choose, however, to calculate new utility allowances more frequently than once during the calendar year provided the owner complies with the requirements of these regulations, including the notification requirements to the Agency and tenants.

Another commentator suggested that new utility allowances should be implemented within 90 days after HUD publishes its annual income limits (which are used in determining section 42 rents), but in no case later than June 30 of any year. Section 42 rents under section 42(g)(2) may or may not increase depending on HUD's calculation of area median gross income. Therefore, the IRS and Treasury Department do not believe that the rules should require that the effective date of any new utility allowance coincide with the section 42 effective date of HUD's income lists. Building owners, however, may choose to implement any new utility allowances on the section 42 effective date of HUD's income lists.

To bring financial stability to a project during the beginning of its operations, the final regulations clarify that the building owner is not required to review the utility allowances, or implement new utility allowances, until the earlier of the date 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.

Procedural safeguards for tenants

One commentator made several recommendations regarding procedural safeguards for tenants including: owners should be required to give tenants 30 days notice before the effective date of any utility allowance; tenants should be provided with all information used in calculating the utility allowances; tenants should be given the opportunity to comment on the proposed allowances; and owners should be required to review those comments prior to the utility allowances becoming effective. The commentator believed that the new options for determining utility allowances should be available only after one full year of occupancy and one full year after the building is placed in service. A commentator also recommended that a building owner should be allowed to use the new options only if the owner provides all data to the Agency no later than February 15 and the Agency informs the owner whether the proposed utility allowances are approved by March 31.

To provide tenants with the opportunity to comment on proposed utility allowances to the Agency and building owner, the final regulations apply the existing disclosure requirement under current §1.42–10(b)(4)(ii)(B) (regarding the utility company estimate) to an owner using a utility company estimate, the HUD Utility Schedule Model, or an energy consumption model. Therefore, an owner must submit copies of the proposed utility allowances to the Agency and make the proposed utility allowances available to all tenants in the building at the beginning of the 90-day period before the utility allowances are used in determining the gross rents of rent-restricted units. Similarly, the final regulations require that any utility estimates obtained under the Agency estimate option must be made available to all tenants in the building at the beginning of the 90-day period. An Agency may continue to require additional information from the owner during the 90-day period.

Commentators suggested that the final regulations should limit the use of the HUD Utility Schedule Model to data for a twelve-month period ending in the most recent calendar year and require the owner to certify the accuracy of the data and the calculations of the utility allowances. However, the HUD Utility Schedule Model already incorporates consumption data derived from RECS data. Thus, building owners using this option need not be required to use consumption data for any particular twelve-month period. These final regulations, however, provide that the use of the energy consumption model is limited to consumption data for a twelve-month period ending no earlier than 60 days prior to the beginning of the 90-day period. In the case of newly constructed or renovated buildings with less than twelve months of consumption data, the energy consumption model allows a qualified professional to use consumption data for the twelve-month period of units of similar size and construction in the geographic area in which the building containing the units is located. Further, the final regulations require that utility rates used for the HUD Utility Schedule Model, the Agency estimate option, and the energy consumption model must be no older than the rates in place 60 days prior to the beginning of the 90-day period.

In addition to these safeguards, if an Agency determines that a building owner has understated the utility allowances for the owner's building under the particular option chosen, and, therefore, some or all of the units in the building are not rent-restricted units under section 42(g)(2), then the Agency must report the noncompliance to the Service on Form 8823, *Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition*.

Commentators requested that building owners should be required to certify the estimate and the accuracy of the data used

under the new options. Because Agencies may request additional information at any time during their mandatory review of proposed utility allowances, and must report any noncompliance to the Service, the final regulations do not require building owners to provide such certification.

Utility allowances for tenants with special needs

One commentator suggested that the calculation of utility allowances should take into account any special needs tenants such as people with disabilities who require high energy consumption equipment. Section 42 does not require that the owner's calculation of utility allowances be based on a tenant's particular use of utility services. If such a requirement were imposed, owners and Agencies would have to determine the utility allowance for the tenants in each unit, as opposed to allowances based on the size of the unit, which would greatly increase burden. Additionally, it is unclear whether it is appropriate to implement rules that might encourage tenants to be indifferent to their energy consumption. Such indifference could lead to cost overruns by owners, and the viability of low-income housing could be jeopardized. Therefore, the final regulations do not require the calculation of utility allowances based on consumption by particular tenants.

Calculation of utility company estimate option for deregulated utilities

Section 1.42–10(b)(4)(ii)(B) currently provides that any interested party (including an owner, low-income tenant, or 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 units is located. In light of utility services deregulation, the proposed regulations proposed to amend this option by requiring the interested party to obtain cost estimates from the local utility company that include combined rate charges from multiple utility companies.

Commentators thought this proposed amendment would require the interested party to obtain utility consumption estimates from every utility company providing the same utility service and stated that this would present an unworkable administrative burden in deregulated jurisdictions with multiple utility providers. In some jurisdictions, many utility providers may be available for a given building. The proposed amendment was not intended to require the interested party to obtain utility consumption estimates from every utility company providing the same utility service. The amendment was proposed to address deregulation by requiring the interested party to obtain estimates for all the components of the utility service if the service is divided between two or more types of service providers (for example, electric generation and electric transmission). The final regulations clarify that, in the case of deregulated utility services, the interested party is required to obtain an estimate from only one utility company even if multiple companies can provide the same utility service to a unit. However, the utility company furnishing the estimate 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 charges for providing the utility service.

Agency costs/administrative burden

One commentator requested that specific language be added to address when Agencies may charge a reasonable fee for making a determination pursuant to the Agency estimate option, and who bears the fee when a particular option is used. The proposed regulations provided that costs incurred in obtaining an Agency estimate are borne by the building owner. The final regulations adopt this provision, and further require building owners to pay for all costs incurred in obtaining the estimates under the HUD Utility Schedule Model and the energy consumption model and in providing estimates to Agencies and tenants.

Effective/applicability date

The proposed regulations were proposed to be effective for taxable years beginning on or after the date of publication of the final regulations in the **Federal Register**. A commentator suggested that the final regulations be effective earlier on the basis that if they are published after 2007, they would not be effective until 2009 for calendar year taxpayers. The IRS and Treasury Department believe that the burden associated with an earlier effective date is not warranted. Therefore, the final regulations do not adopt this suggestion. However, in order to allow a building owner to implement the utility allowances as of the first day of the owner's taxable year beginning on or after July 29, 2008, the final regulations provide that taxpayers may rely on the rules for determining utility allowances before the first day of the owner's taxable year beginning on or after July 29, 2008 provided that any utility allowances so calculated are effective no earlier than the first day of the owner's taxable year beginning on or after July 29, 2008.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the information has previously been reviewed and approved under OMB control number 1545–1102, and that the information required by these final regulations adds no new burden to the existing requirements. Accordingly, a Regulatory Flexibility Analysis under the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is David Selig, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury

Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.42–10 is amended by:

1. Revising the first sentence of paragraph (a).
2. Revising paragraphs (b)(1), (b)(2), and (b)(3), and the introductory text of paragraph (b)(4).
3. Adding two sentences at the end of paragraph (b)(4)(ii)(A).
4. Adding three sentences after the second sentence in paragraph (b)(4)(ii)(B).
5. Adding paragraphs (b)(4)(ii)(C), (b)(4)(ii)(D), and (b)(4)(ii)(E).
6. Revising paragraph (c).
7. Adding paragraph (d).

The additions and revisions read as follows:

§1.42–10 Utility allowances.

(a) * * * 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. * * *

(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.

* * * * *

(ii) * * * (A) * * * 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) * * * 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. * * *

(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 *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).

Par. 3. Section 1.42–12 is amended by adding paragraph (a)(4) to read as follows:

§1.42–12 Effective dates and transitional rules.

(a) * * *

(4) *Utility allowances*. The first sentence in §1.42–10(a), §1.42–10(b)(1), (2), (3), and (4), the last two sentences in §1.42–10(b)(4)(ii)(A), the third, fourth, and fifth sentences in §1.42–10(b)(4)(ii)(B), §1.42–10(b)(4)(ii)(C), (D), and (E), and §1.42–10(c) and (d) are applicable to a building owner's taxable years beginning on or after July 29, 2008. Taxpayers may rely on these provisions before the beginning of the building owner's taxable year beginning on or after July 29, 2008 provided that any utility allowances calculated under these provisions are effective no earlier than the first day of the building owner's taxable year beginning on or after July 29, 2008. The utility allowances provisions that apply to taxable years beginning before July 29, 2008 are contained in §1.42–10 (see 26 CFR part 1 revised as of April 1, 2008).

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved July 20, 2008.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 28, 2008, 8:45 a.m., and published in the issue of the Federal Register for July 29, 2008, 73 F.R. 43863)

Section 2642.—Inclusion Ratio

26 CFR 2642–6: Qualified severance.

T.D. 9421

Department of the Treasury Internal Revenue Service 26 CFR Part 26

Severance of a Trust for Generation-Skipping Transfer (GST) Tax Purposes

AGENCY: Internal Revenue Service (IRS), Department of the Treasury (Treasury).

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the generation-skipping transfer (GST) tax consequences of the severance of a trust in a manner that is effective under state law, but that does not meet the requirements of a qualified severance under section 2642(a)(3) of the Internal Revenue Code (Code). These final regulations also provide guidance regarding the GST tax consequences of a qualified severance of a trust with an inclusion ratio between zero and one into more than two resulting trusts. These final regulations also provide special funding rules applicable to the non-*pro rata* division of certain assets between or among resulting trusts. The regulations will affect trusts that are subject to the GST tax.

DATES: *Effective Date:* The regulations are effective July 31, 2008.

Applicability Date: For dates of applicability, see §26.2642–6(k)(1).

FOR FURTHER INFORMATION CONTACT: Mayer R. Samuels, (202) 622–3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 2642(a)(3) was added to the Code by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Public Law 107–16 (115 Stat. 38 (2001). Under section 2642(a)(3), if a trust is divided into two or more trusts in a "qualified severance," the separate trusts resulting from the severance (resulting trusts), which may have different inclusion ratios, will be recognized as separate trusts for GST tax purposes. (As used in this guidance, "resulting trust" has no relation to a resulting trust recognized under the common law of trusts and principles of equity.) Once the resulting trusts are recognized as separate trusts, the transferor's lifetime GST tax exemption may be allocated separately to either trust. In addition, whether or not a GST taxable event occurs is determined separately for each resulting trust.

On August 24, 2004, proposed regulations under section 2642(a)(3) regarding qualified severances were published in the **Federal Register** (REG–145987–03, 2004–2 C.B. 523 [69 FR 51967]). Final regulations were published on August 2, 2007 (T.D. 9348, 2007–37 I.R.B. 563 [72 FR 42291]). The Treasury Department and IRS determined that certain comments received in response to the proposed regulations, and certain additional rules under section 2642(a)(3), should be addressed in a separate notice of proposed rulemaking. On August 2, 2007, the **Federal Register** published a notice of proposed rulemaking (REG–128843–05, 2007–37 I.R.B. 587 [72 FR 42340]) addressing those comments and rules. The IRS received one submission containing several comments on the notice of proposed rulemaking. The comments contained in the submission are discussed below. No public hearing was requested or held.

Explanation of Provisions and Summary of Comments

Section 26.2642–6(d)(4) of the existing regulations provides that each of the trusts resulting from a qualified severance must be funded with a fraction or percentage of the original trust, and that the sum of those fractions or percentages must be one or one hundred percent, respectively. The existing regulations provide that this requirement may be satisfied by the funding of each resulting trust with that trust's fraction or percentage share of each asset held by the original trust (a *pro rata* division). Section 26.2642–6(d)(4) of the proposed regulations permits the funding of the resulting trusts on a non-*pro rata* basis, provided that a special funding rule is also satisfied. Specifically, this section of the proposed regulations provides that, if the assets of the original trust are divided between or among the resulting trusts on a non-*pro rata* basis, no discounts or other reductions from the value of the asset owned by the original trust, arising by reason of the division of the original trust's interest in the asset between or among the resulting trusts, are permitted for purposes of determining the amount used to fund each resulting trust. Instead, solely for funding purposes, each resulting trust's interest in the stock of a closely held corporation, partnership interest, or other asset must be valued by multiplying the fair market value of the asset held in the original trust as of the date of severance by the fractional or percentage interest in that asset being distributed to that resulting trust. Thus, for purposes of the requirements of a qualified severance, regardless of whether the funding is done on a *pro rata* basis, the cumulative value of the resulting trusts equals the value of the original trust.

The commentators pointed out that funding pursuant to this rule would result in an allocation different from the allocation that would normally be obtained from funding based on the state law fair market value standard which would take the discounts into account. The commentators expressed concern that the resulting shift in beneficial interests between or among the resulting trusts could violate the trustee's fiduciary duty of impartiality under applicable state law. Further, the commentators pointed out that the proposed rule could be avoided through the post-severance purchase and sale of assets between resulting trusts at fair market value. The commentators recommended an alternative funding rule under which the value of the original trust would be calculated as the sum of the fair market value of the assets to be held by the resulting trusts.

This recommendation was not adopted in the final regulations. It is difficult to see how the fiduciary duty of impartiality is challenged more by this funding rule than by a *pro rata* division of each asset of the original trust. The funding rule in the proposed regulations was intended to facilitate the funding of the resulting trusts without the cost or need for review of appraisals of each severed interest, and thus to improve the administrability of the severance provisions. This funding rule produces a bright line test, the same result whether or not the trust assets are divided on a *pro rata* basis, and recognizes that in many circumstances, where a trust is severed for tax purposes into two identical trusts with the same or related beneficiaries, any closely held stock or partnership units divided between the two resulting trusts are likely to be sold as a unit without any actual reduction in value that may be reflected in the claimed discounts. Any use of post-severance sales between resulting trusts to avoid these funding rules may constitute mere steps in a pre-arranged transaction.

The commentators pointed out that the nonqualified severance illustrated in

§26.2642–6(j), *Example 3*, of the existing regulations will result in a taxable event for GST tax purposes (that is, a taxable termination or taxable distribution) if that severance occurs on or after the proposed regulations are adopted as final. This is because, under the proposed regulations, the severed trust is treated as a separate trust for GST tax purposes. Accordingly, cautionary language has been added to this example to the effect that a GST taxable event will result as a consequence of the severance.

It was determined that §26.2642–6(j), *Example 12* of the proposed regulations addresses the same issue covered in *Example 8* of §26.2654–1(a)(5). Therefore, *Example 12* has been removed from the final regulations and the examples have been renumbered accordingly.

As requested by the commentators, a new example, §26.2642–6(j), *Example 13*, has been added to confirm that a trust resulting from a nonqualified severance may subsequently be severed in a qualified severance.

The commentators noted that the proposed regulations under §26.2654–1(a)(1)(iii) address the treatment of severances resulting in separate trusts that are required under the terms of a trust instrument (mandatory severances) but that are neither severances otherwise recognized under section 2654 nor qualified severances under section 2642. The proposed regulations conclude that the separate shares or trusts resulting from such a severance, if recognized as separate trusts under state law, will be recognized as separate for GST tax purposes. The commentators questioned why the proposed changes to the regulations under section 2654 must address those severances that result in separate trusts when this issue is already addressed in §26.2642–6(h) of the proposed regulations dealing with nonqualified severances. Section 26.2654–1(a)(1)(iii) was intended to address only mandatory severances that, as with the other types of severances covered by §26.2654–1(a), are dictated by the terms of the trust. On the other hand, §26.2642–6(h) addresses discretionary severances, that is, severances that are elective and within the discretion of the trustee. The severances described in §26.2654–1 are governed by that section. Therefore, the proposed addition to this section has not been removed.

The proposed regulations under section 2654 state a general rule that separate shares or trusts resulting from a mandatory severance, that are recognized as separate trusts for GST tax purposes, will not be treated as separate trusts for purposes of filing income tax returns or calculating any other taxes. The comments noted that this statement should not apply to shares or trusts that are recognized as separate trusts under local law. Rather, this statement should apply only to separate shares created within a single trust that are not recognized under local law as separate trusts. The final regulations reflect this change.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) applies only to §26.2642–6(d)(7)(iii) of these regulations. It is hereby certified that this provision will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required. This provision directly affects individuals, not entities. Because the remaining sections of these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these final regulations is Mayer R. Samuels, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. Other personnel from the IRS and Treasury participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 26 is amended as follows:

PART 26—GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

Paragraph 1. The authority citation for part 26 continues to read in part as follows:

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

Par. 2. In §26.2600–1, the table of contents is amended by adding the entry for §26.2642–6(h) to read as follows:

§26.2600–1 Table of contents.

* * * * *

§26.2642–6 Qualified severance.

* * * * *

(h) Treatment of trusts resulting from a severance that is not a qualified severance.

* * * * *

Par. 3. Section 26.2642–6 is amended as follows:

1. Paragraphs (d)(4) and (d)(7) are revised.
2. Paragraph (h) is added.
3. Paragraph (j) *Example 3* is revised.
4. Paragraph (j) *Examples 6*, *9*, *12*, and *13* are added.
5. Paragraph (k)(1) is revised.

The additions and revisions read as follows:

§26.2642–6 Qualified severance.

* * * * *

(d) * * *

(4) The single trust (original trust) is severed on a fractional basis, such that each new trust (resulting trust) is funded with a fraction or percentage of the original trust, and the sum of those fractions or percentages is one or one hundred percent, respectively. For this purpose, the fraction or percentage may be determined by means of a formula (for example, that fraction of the trust the numerator of which is equal to the transferor's unused GST tax exemption, and the denominator of which is the fair market value of the original trust's assets on the date of severance).

The severance of a trust based on a pecuniary amount does not satisfy this requirement. For example, the severance of a trust is not a qualified severance if the trust is divided into two trusts, with one trust to be funded with $1,500,000 and the other trust to be funded with the balance of the original trust's assets. With respect to the particular assets to be distributed to each separate trust resulting from the severance, each such trust may be funded with the appropriate fraction or percentage (*pro rata* portion) of each asset held by the original trust. Alternatively, the assets may be divided among the resulting trusts on a non-*pro rata* basis, based on the fair market value of the assets on the date of severance. However, if a resulting trust is funded on a non-*pro rata* basis, each asset received by a resulting trust must be valued, solely for funding purposes, by multiplying the fair market value of the asset held in the original trust as of the date of severance by the fraction or percentage of that asset received by that resulting trust. Thus, the assets must be valued without taking into account any discount or premium arising from the severance, for example, any valuation discounts that might arise because the resulting trust receives less than the entire interest held by the original trust. See paragraph (j), *Example 6* of this section.

* * * * *

(7)(i) In the case of a qualified severance occurring after GST tax exemption has been allocated to the trust (whether by an affirmative allocation, a deemed allocation, or an automatic allocation pursuant to the rules contained in section 2632), if the trust has an inclusion ratio as defined in §26.2642–1 that is greater than zero and less than one, then either paragraph (d)(7)(ii) or (iii) of this section must be satisfied.

(ii) The trust is severed initially into only two resulting trusts. One resulting trust must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the applicable fraction, as defined in §26.2642–1(b) and (c), used to determine the inclusion ratio of the original trust immediately before the severance. The other resulting trust must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the excess of one over the fractional share described in the preceding sentence. The trust receiving the fractional share equal to the applicable fraction shall have an inclusion ratio of zero, and the other trust shall have an inclusion ratio of one. If the applicable fraction with respect to the original trust is .50, then, with respect to the two equal trusts resulting from the severance, the trustee may designate which of the resulting trusts will have an inclusion ratio of zero and which will have an inclusion ratio of one. Each separate trust resulting from the severance then may be further divided in accordance with the rules of this section. See paragraph (j), *Example 7*, of this section.

(iii) The trust is severed initially into more than two resulting trusts. One or more of the resulting trusts in the aggregate must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the applicable fraction used to determine the inclusion ratio of the original trust immediately before the severance. The trust or trusts receiving such fractional share shall have an inclusion ratio of zero, and each of the other resulting trust or trusts shall have an inclusion ratio of one. (If, however, two or more of the resulting trusts each receives the fractional share of the total value of the original trust equal to the applicable fraction, the trustee may designate which of those resulting trusts will have an inclusion ratio of zero and which will have an inclusion ratio of one.) The resulting trust or trusts with an inclusion ratio of one must receive in the aggregate that fractional share of the total value of the original trust as of the date of severance that is equal to the excess of one over the fractional share described in the second sentence of this paragraph. See paragraph (j), *Example 9*, of this section.

* * * * *

(h) *Treatment of trusts resulting from a severance that is not a qualified severance*. Trusts resulting from a severance (other than a severance recognized for GST tax purposes under §26.2654–1) that does not meet the requirements of a qualified severance under paragraph (b) of this section will be treated, after the date of severance, as separate trusts for purposes of the GST tax, provided that the trusts resulting from such severance are recognized as separate trusts under applicable state law. The post-severance treatment of the resulting trusts as separate trusts for GST tax purposes generally permits the allocation of GST tax exemption, the making of various elections permitted for GST tax purposes, and the occurrence of a taxable distribution or termination with regard to a particular resulting trust, with no GST tax impact on any other trust resulting from that severance. Each trust resulting from a severance described in this paragraph (h), however, will have the same inclusion ratio immediately after the severance as that of the original trust immediately before the severance. (See §26.2654–1 for the inclusion ratio of each trust resulting from a severance described in that section.) Further, any trust resulting from a nonqualified severance may be severed subsequently, pursuant to a qualified severance described in this §26.2642–6.

* * * * *

(j) * * *

Example 3. Severance based on actuarial value of beneficial interests. In 2004, T establishes Trust, an irrevocable trust providing that income is to be paid to T's child C during C's lifetime. Upon C's death, Trust is to terminate and the assets of Trust are to be paid to GC, C's child, if living, or, if GC is not then living, to GC's estate. T properly elects, under section 2632(c)(5), not to have the automatic allocation rules contained in section 2632(c) apply with respect to T's transfers to Trust, and T does not otherwise allocate GST tax exemption with respect to Trust. Thus, Trust has an inclusion ratio of one. In 2009, the trustee of Trust, pursuant to applicable state law, divides Trust into two separate trusts, Trust 1 for the benefit of C (and on C's death to C's estate), and Trust 2 for the benefit of GC (and on GC's death to GC's estate). The document severing Trust directs that Trust 1 is to be funded with an amount equal to the actuarial value of C's interest in Trust prior to the severance, determined under section 7520 of the Internal Revenue Code. Similarly, Trust 2 is to be funded with an amount equal to the actuarial value of GC's interest in Trust prior to the severance, determined under section 7520. Trust 1 and Trust 2 do not provide for the same succession of interests as provided under the terms of the original trust. Therefore, the severance is not a qualified severance. Furthermore, because the severance results in no non-skip person having an interest in Trust 2, Trust 2 constitutes a skip person under section 2613 and, therefore, the severance results in a taxable termination subject to GST tax.

* * * * *

Example 6. Funding of severed trusts on a non-pro rata basis. (i) T's will establishes an irrevocable trust (Trust) for the benefit of T's descendants. As a result of the allocation of GST tax exemption, the applicable fraction with respect to Trust is .60 and Trust's inclusion ratio is .40 [1 - .60]. Pursuant to authority granted under applicable state law, on August 1, 2008, the trustee executes a document severing Trust into two trusts, Trust 1 and Trust 2, each of

which is identical to Trust. The instrument of severance provides that the severance is intended to qualify as a qualified severance within the meaning of section 2642(a)(3) and designates August 3, 2008, as the date of severance (within the meaning of paragraph (d)(3) of this section). The instrument further provides that Trust 1 and Trust 2 are to be funded on a non-*pro rata* basis with Trust 1 funded with assets having a fair market value on the date of severance equal to 40% of the value of Trust's assets on that date and Trust 2 funded with assets having a fair market value equal to 60% of the value of Trust's assets on that date. The fair market value of the assets used to fund each trust is to be determined in compliance with the requirements of paragraph (d)(4) of this section.

(ii) On August 3, 2008, the fair market value of the Trust assets totals $4,000,000, consisting of 52% of the outstanding common stock in Company, a closely-held corporation, valued at $3,000,000 and $1,000,000 in cash and marketable securities. Trustee proposes to divide the Company stock equally between Trust 1 and Trust 2, and thus transfer 26% of the Company stock to Trust 1 and 26% of the stock to Trust 2. In addition, the appropriate amount of cash and marketable securities will be distributed to each trust. In accordance with paragraph (d)(4) of this section, for funding purposes, the interest in the Company stock distributed to each trust is valued as a *pro rata* portion of the value of the 52% interest in Company held by Trust before severance, without taking into account, for example, any valuation discount that might otherwise apply in valuing the noncontrolling interest distributed to each resulting trust.

(iii) Accordingly, for funding purposes, each 26% interest in Company stock distributed to Trust 1 and Trust 2 is valued at $1,500,000 (.5 x $3,000,000). Therefore, Trust 1, which is to be funded with $1,600,000 (.40 x $4,000,000), receives $100,000 in cash and marketable securities valued as of August 3, 2008, in addition to the Company stock, and Trust 2, which is to be funded with $2,400,000 (.60 x $4,000,000), receives $900,000 in cash and marketable securities in addition to the Company stock. Therefore, the severance is a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied.

* * * * *

Example 9. Regulatory qualified severance. (i) In 2004, T establishes an *inter vivos* irrevocable trust (Trust) providing that trust income is to be paid annually in equal shares to T's children, A and B, for 10 years. Trust provides that the trustee has discretion to make additional distributions of principal to A and B during the 10-year term without adjustments to their shares of income or the trust remainder. If either (or both) dies prior to the expiration of the 10-year term, the deceased child's share of trust income is to be paid to the child's then living descendants, per stirpes, for the balance of the trust term. At the expiration of the 10-year term, the corpus is to be distributed equally to A and B; if A and B (or either or them) is not then living, then such decedent's share is to be distributed instead to such decedent's then living descendants, per stirpes. T allocates GST tax exemption to Trust such that Trust's applicable fraction is .25 and its inclusion ratio is .75.

(ii) In 2006, pursuant to applicable state law, the trustee severs the trust into three trusts: Trust 1, Trust 2, and Trust 3. The instrument severing Trust provides that Trust 1 is to receive 50% of Trust's assets, Trust 2 is to receive 25% of Trust's assets, and Trust 3 is to receive 25% of Trust's assets. All three resulting trusts are identical to Trust, except that each has different beneficiaries: A and A's issue are designated as the beneficiaries of Trust 1, and B and B's issue are designated as the beneficiaries of Trust 2 and Trust 3. The severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied. Trust 1 will have an inclusion ratio of 1. Because both Trust 2 and Trust 3 have each received the fractional share of Trust's assets equal to Trust's applicable fraction of .25, trustee designates that Trust 2 will have an inclusion ratio of one and that Trust 3 will have an inclusion ratio of zero.

* * * * *

Example 12. Other severance that does not meet the requirements of a qualified severance. (i) In 2004, T establishes an irrevocable *inter vivos* trust (Trust) providing that Trust income is to be paid to T's children, A and B, in equal shares for their joint lives. Upon the death of the first to die of A and B, all Trust income will be paid to the survivor of A and B. At the death of the survivor, the corpus is to be distributed in equal shares to T's grandchildren, W and X (with any then-deceased grandchild's share being paid in accordance with that grandchild's testamentary general power of appointment). W is A's child and X is B's child. T elects under section 2632(c)(5) not to have the automatic allocation rules contained in section 2632(c) apply with respect to T's transfers to Trust, but T allocates GST tax exemption to Trust resulting in Trust having an inclusion ratio of .30.

(ii) In 2009, the trustee of Trust, as permitted by applicable state law, divides Trust into two separate trusts, Trust 1 and Trust 2. Trust 1 provides that trust income is to be paid to A for life and, on A's death, the remainder is to be distributed to W (or pursuant to W's testamentary general power of appointment). Trust 2 provides that trust income is to be paid to B for life and, on B's death, the remainder is to be distributed to X (or pursuant to X's testamentary general power of appointment). Because Trust 1 and Trust 2 do not provide A and B with the contingent survivor income interests that were provided to A and B under the terms of Trust, Trust 1 and Trust 2 do not provide for the same succession of interests in the aggregate as provided by Trust. Therefore, the severance does not satisfy the requirements of this section and is not a qualified severance. Provided that Trust 1 and Trust 2 are recognized as separate trusts under applicable state law, Trust 1 and Trust 2 will be recognized as separate trusts for GST tax purposes pursuant to paragraph (h) of this section, prospectively from the date of the severance. However, Trust 1 and Trust 2 each have an inclusion ratio of .30 immediately after the severance, the same as the inclusion ratio of Trust prior to severance.

Example 13. Qualified severance following a non-qualified severance. Assume the same facts as in *Example 12*, except that, as of November 4, 2010, the trustee of Trust 1 severs Trust 1 into two trusts, Trust 3 and Trust 4, in accordance with applicable local law. The instrument severing Trust 1 provides that both resulting trusts have provisions identical to Trust 1. The terms of the instrument severing Trust 1 further provide that Trust 3 is to be funded on a *pro rata* basis with assets having a fair market value as of the date of severance equal to 70% of the value of Trust 1's assets on that date, and Trust 4 is to be funded with assets having a fair market value as of the date of severance equal to 30% of the value of Trust 1's assets on that date. The severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied. Trust 3 will have an inclusion ratio of zero and Trust 4 will have an inclusion ratio of one.

(k) * * *

(1) *In general*. Except as otherwise provided in this paragraph (k), this section applies to severances occurring on or after August 2, 2007. Paragraph (d)(7)(iii), paragraph (h), and *Examples 9*, *12* and *13* of paragraph (j) of this section apply to severances occurring on or after September 2, 2008.

Par. 4. Section 26.2654–1 is amended as follows:

1. Paragraph (a)(1)(i) is revised.
2. Paragraph (a)(1)(iii) is added.
3. In paragraph (a)(5), *Example 8* is revised.
4. Paragraph (d) is added.

The additions and revisions read as follows:

§26.2654–1 Certain trusts treated as separate trusts.

(a) * * *(1) * * *(i) * * * If a single trust consists solely of substantially separate and independent shares for different beneficiaries, the share attributable to each beneficiary (or group of beneficiaries) is treated as a separate trust for purposes of Chapter 13. The phrase "substantially separate and independent shares" generally has the same meaning as provided in §1.663(c)–3. However, except as provided in paragraph (a)(1)(iii) of this section, a portion of a trust is not a separate share unless such share exists from and at all times after the creation of the trust. For purposes of this paragraph (a)(1), a trust is treated as created at the date of death of the grantor if the trust is includible in its entirety in the grantor's gross estate for Federal estate tax purposes. Further, except with respect to shares or trusts that are treated as separate trusts under local law, treatment of a single trust as separate trusts under this paragraph (a)(1) does not permit treatment of those portions as separate trusts for purposes of filing returns and payment of tax or for purposes of computing any other tax imposed under the Internal Revenue Code. Also, additions to, and distributions from,

such trusts are allocated *pro rata* among the separate trusts, unless the governing instrument expressly provides otherwise. See §26.2642–6 and paragraph (b) of this section regarding the treatment, for purposes of Chapter 13, of separate trusts resulting from the discretionary severance of a single trust.

* * * * *

(iii) *Mandatory severances*. For purposes of this section, if the governing instrument of a trust requires the division or severance of a single trust into separate trusts upon the future occurrence of a particular event not within the discretion of the trustee or any other person, and if the trusts resulting from such a division or severance are recognized as separate trusts under applicable state law, then each resulting trust is treated as a separate trust for purposes of Chapter 13. For this purpose, the rules of paragraph (b)(1)(ii)(C) of this section apply with respect to the severance and funding of the trusts. Similarly, if the governing instrument requires the division of a single trust into separate shares under the circumstances described in this paragraph, each such share is treated as a separate trust for purposes of Chapter 13. The post-severance treatment of the resulting shares or trusts as separate trusts for GST tax purposes generally permits the allocation of GST tax exemption, the making of various elections permitted for GST tax purposes, and the occurrence of a taxable distribution or termination with regard to a particular resulting share or trust, with no GST tax impact on any other trust or share resulting from that severance. The treatment of a single trust as separate trusts under this paragraph (a)(1), however, does not permit treatment of those portions as separate trusts for purposes of filing returns and payment of tax or for purposes of computing any other tax imposed under the Internal Revenue Code, if those portions are not treated as separate trusts under local law. Also, additions to, and distributions from, such trusts are allocated *pro rata* among the separate trusts, unless the governing instrument expressly provides otherwise. Each separate share and each trust resulting from a mandatory division or severance described in this paragraph will have the same inclusion ratio immediately after the severance as that of the original trust immediately before the division or severance.

* * * * *

(5) * * *

Example 8. Subsequent mandatory division into separate trusts. T creates an irrevocable trust that provides the trustee with the discretionary power to distribute income or corpus to T's children and grandchildren. The trust provides that, when T's youngest child reaches age 21, the trust will be divided into separate shares, one share for each child of T. The income from a respective child's share will be paid to the child during the child's life, with the remainder passing on the child's death to such child's children (grandchildren of T). The separate shares that come into existence when the youngest child reaches age 21 will be recognized as of that date as separate trusts for purposes of Chapter 13. The inclusion ratio of the separate trusts will be identical to the inclusion ratio of the trust before the severance. Any allocation of GST tax exemption to the trust after T's youngest child reaches age 21 may be made to any one or more of the separate shares. The result would be the same if the trust instrument provided that the trust was to be divided into separate trusts when T's youngest child reached age 21, provided that the severance and funding of the separate trusts meets the requirements of this section.

* * * * *

(d) *Effective date*. Paragraph (a)(1)(i), paragraph (a)(1)(iii), and *Example* 8 of paragraph (a)(5) apply to severances occurring on or after September 2, 2008.

* * * * *

Sherri L. Brown,
(Acting) Deputy Commissioner for Services and Enforcement.

Approved July 20, 2008.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 30, 2008, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2008, 73 F.R. 44649)

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rates of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 2008, will be 6 percent for overpayments (5 percent in the case of a corporation), 6 percent for underpayments, and 8 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 3.5 percent.

Rev. Rul. 2008–47

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See section 6621(c) and section 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies during the first calendar quarter beginning after that month. Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during that month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988–1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which,

pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of July 2008 is 3 percent. Accordingly, an overpayment rate of 6 percent (5 percent in the case of a corporation) and an underpayment rate of 6 percent are established for the calendar quarter beginning October 1, 2008. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning October 1, 2008, is 3.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning October 1, 2008, is 8 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 3.5 percent, 5 percent, 6 percent, and 8 percent are published in Tables 12, 63, 65, and 69 of Rev. Proc. 95–17, 1995–1 C.B. 556, 566, 617, 619, and 623.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Deborah Colbert-James of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Colbert-James at (202) 622–8143 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 — PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 — DEC. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 — DEC. 31, 1998 – Continued

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

		1995–1 C.B.	
	RATE	TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT – Continued

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995–1 C.B. TABLE	PG
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	7%	19	573
Apr. 1, 2006—Jun. 30, 2006	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	8%	21	575
Apr. 1, 2007—Jun. 30, 2007	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	8%	21	575
Jan. 1, 2008—Mar. 31, 2008	7%	67	621
Apr. 1, 2008—Jun. 30, 2008	6%	65	619
Jul. 1, 2008—Sep. 30, 2008	5%	63	617
Oct. 1, 2008—Dec. 31, 2008	6%	65	619

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	5%	15	569	6%	17	571

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT – Continued

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Oct. 1, 2002—Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	4%	61	615	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	3%	59	613	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	4%	61	615	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	4%	13	567	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	5%	15	569	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	5%	15	569	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	6%	17	571	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	6%	17	571	7%	19	573
Apr. 1, 2006—Jun. 30, 2006	6%	17	571	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	7%	19	573	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	7%	19	573	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	7%	19	573	8%	21	575
Apr. 1, 2007—Jun. 30, 2007	7%	19	573	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	7%	19	573	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	7%	19	573	8%	21	575
Jan. 1, 2008—Mar. 31, 2008	6%	65	619	7%	67	621
Apr. 1, 2008—Jun. 30, 2008	5%	63	617	6%	65	619
Jul. 1, 2008—Sep. 30, 2008	4%	61	615	5%	63	617
Oct. 1, 2008—Dec. 31, 2008	5%	63	617	6%	65	619

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 — PRESENT

		1995–1 C.B.	
	RATE	TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 — PRESENT – Continued

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577
Oct. 1, 2001—Dec. 31, 2001	9%	23	577
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575
Jul. 1, 2002—Sep. 30, 2002	8%	21	575
Oct. 1, 2002—Dec. 30, 2002	8%	21	575
Jan. 1, 2003—Mar. 31, 2003	7%	19	573
Apr. 1, 2003—Jun. 30, 2003	7%	19	573
Jul. 1, 2003—Sep. 30, 2003	7%	19	573
Oct. 1, 2003—Dec. 31, 2003	6%	17	571
Jan. 1, 2004—Mar. 31, 2004	6%	65	619
Apr. 1, 2004—Jun. 30, 2004	7%	67	621
Jul. 1, 2004—Sep. 30, 2004	6%	65	619
Oct. 1, 2004—Dec. 31, 2004	7%	67	621
Jan. 1, 2005—Mar. 31, 2005	7%	19	573
Apr. 1, 2005—Jun. 30, 2005	8%	21	575
Jul. 1, 2005—Sep. 30, 2005	8%	21	575
Oct. 1, 2005—Dec. 31, 2005	9%	23	577
Jan. 1, 2006—Mar. 31, 2006	9%	23	577
Apr. 1, 2006—Jun. 30, 2006	9%	23	577
Jul. 1, 2006—Sep. 30, 2006	10%	25	579
Oct. 1, 2006—Dec. 31, 2006	10%	25	579
Jan. 1, 2007—Mar. 31, 2007	10%	25	579
Apr. 1, 2007—Jun. 30, 2007	10%	25	579
Jul. 1, 2007—Sep. 30, 2007	10%	25	579
Oct. 1, 2007—Dec. 31, 2007	10%	25	579
Jan. 1, 2008—Mar. 31, 2008	9%	71	625
Apr. 1, 2008—Jun. 30, 2008	8%	69	623
Jul. 1, 2008—Sep. 30, 2008	7%	67	621
Oct. 1, 2008—Dec. 31, 2008	8%	69	623

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 — PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002—Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002—Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003—Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003—Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003—Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003—Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004—Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004—Jun. 30, 2004	2.5%	58	612
Jul. 1, 2004—Sep. 30, 2004	1.5%	56	610
Oct. 1, 2004—Dec. 31, 2004	2.5%	58	612
Jan. 1, 2005—Mar. 31, 2005	2.5%	10	564
Apr. 1, 2005—Jun. 30, 2005	3.5%	12	566
Jul. 1, 2005—Sep. 30, 2005	3.5%	12	566
Oct. 1, 2005—Dec. 31, 2005	4.5%	14	568
Jan. 1, 2006—Mar. 31, 2006	4.5%	14	568
Apr. 1, 2006—Jun. 30, 2006	4.5%	14	568
Jul. 1, 2006—Sep. 30, 2006	5.5%	16	570
Oct. 1, 2006—Dec. 31, 2006	5.5%	16	570
Jan. 1, 2007—Mar. 31, 2007	5.5%	16	570
Apr. 1, 2007—Jun. 30, 2007	5.5%	16	570
Jul. 1, 2007—Sep. 30, 2007	5.5%	16	570
Oct. 1, 2007—Dec. 31, 2007	5.5%	16	570

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 — PRESENT – Continued

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 2008—Mar. 31, 2008	4.5%	62	616
Apr. 1, 2008—Jun. 30, 2008	3.5%	60	614
Jul. 1, 2008—Sep. 30, 2008	2.5%	58	612
Oct. 1, 2008—Dec. 31, 2008	3.5%	12	566

Part III. Administrative, Procedural, and Miscellaneous

Application of Section 382 in the Case of Certain Acquisitions Made Pursuant to the Housing and Economic Recovery Act of 2008

Notice 2008–76

SECTION 1. OVERVIEW

This notice announces that the Internal Revenue Service (IRS) and the Treasury Department (Treasury) will issue regulations under section 382(m) of the Internal Revenue Code (Code) that address the application of section 382 in the case of certain acquisitions made pursuant to the Housing and Economic Recovery Act of 2008.

Pursuant to section 1117(a) and (b) of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110–289 (2008), the Secretary of the Treasury is authorized to purchase any obligations and other securities issued by certain entities under the Housing and Economic Recovery Act of 2008. A purchase that is made pursuant to this authority is hereinafter referred to as a "Housing Act Acquisition."

SECTION 2. REGULATIONS TO BE ISSUED UNDER SECTION 382(m)

The IRS and Treasury will issue regulations under section 382(m) providing that notwithstanding any other provision of the Code or the regulations thereunder, for purposes of section 382 and the regulations thereunder, with respect to a corporation as to which there is a Housing Act Acquisition, the term "testing date" (as defined in § 1.382–2(a)(4)) shall not include any date on or after the date on which the United States (or any agency or instrumentality thereof) (United States) acquires, in a Housing Act Acquisition, stock (including stock described in section 1504(a)(4)) or an option to acquire stock in the corporation.

SECTION 3. EFFECTIVE DATE

The regulations to be issued under section 382(m) that are described in section 2 of this notice will apply on or after September 7, 2008, and will apply unless and until there is additional guidance.

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26 CFR 601.201: Rulings and determination letters. (Also Part I. Sections 103(c), 105(e), 117(b)(2)(A), 164, 170, 403(b)(1)(A)(ii), 454(b)(2), 511(a)(2)(B), 2055, 2106(a)(2), 2522, 4041(g), 4216, 4253(i), 4483(a), 4911, 4940(c), 4941(d), 4942(f), 4945(f), 4946(c).)

Rev. Proc. 2008–55

SECTION 1. GENERAL

.01 PURPOSE

The purpose of this revenue procedure is to designate the Indian tribal entities that appear on the current or future lists of federally recognized Indian tribes published annually by the Department of the Interior, Bureau of Indian Affairs, as Indian tribal governments for purposes of section 7701(a)(40). Indian tribal governments are treated as States for certain purposes under section 7871(a).

.02 BACKGROUND

(1) Internal Revenue Code and Treasury Regulations. The Indian Tribal Governmental Tax Status Act of 1982 (Title II of Pub. L. No. 97–473, 1983–1 C.B. 510, 511, as amended by Pub. L. No. 98–21, 1983–2 C.B. 309, 315) added sections 7701(a)(40) and 7871 to the Code. Section 7871(a) provides that Indian tribal governments (or subdivisions thereof) will be treated as states for certain enumerated federal tax purposes. For example, charitable contributions to or for the use of a tribal government may be deductible under the federal income, gift, and estate tax laws; a tribal government is entitled to exemption from certain excise taxes; taxes imposed by a tribe may be deductible; and public activity bonds may be tax exempt obligations. §§ 7871(a)(1), (a)(3), (a)(4). As originally enacted in 1982, the provisions of section 7871 were temporary. These provisions were made permanent by section 1065 of the Tax Reform Act of 1984, Pub. L. 98–369, 1984–3 (Vol. 1) C.B. 556. Section 7701(a)(40) defines the term Indian tribal government to mean the governing body of any tribe, band, community, village, or group of Indians, or (if applicable) Alaska Natives, which is determined by the Secretary, after consultation with the Secretary of the Interior, to exercise governmental functions.

Temporary Regulation section 305.7701–1(a) provides that a governing body of a tribe, band, pueblo, community, village, or group of native American Indians, or Alaska Natives, qualifies as an Indian tribal government upon determination by the Internal Revenue Service that the governing body exercises governmental functions. Designation of a governing body as an Indian tribal government will be by revenue procedure. The temporary regulation further provides that if a governing body is not currently designated by revenue procedure as an Indian tribal government, and such governing body believes that it qualifies for such designation, the governing body may apply for a ruling from the Internal Revenue Service.

(2) Federally Recognized Indian Tribe List Act and Associated Regulations. Under the Federally Recognized Indian Tribe List Act of 1994, Pub. L. 103–454, 108 Stat. 4791 ("List Act"), the Secretary of the Interior is required to publish annually a list of all federally recognized Indian tribes. The list must reflect all of the tribes that the Secretary of the Interior recognizes to be eligible for the programs and services provided by the United States to Indians because of their status as Indians. 25 USC § 479a–1(b). The United States has a government-to-government relationship with and recognizes the sovereignty of recognized Indian tribes. List Act § 103(2). The Secretary of the Interior recognizes the entities on the list as Indian tribes with a government-to-government relationship with the United States. See 44 Fed. Reg. 7,235 (Feb. 6, 1979); 58 Fed. Reg. 54,364 (Oct. 21, 1993); and 60 Fed. Reg. 9,250 (Feb. 16, 1995). The government-to-government relationship of a tribe that is on this list may not be terminated except by an Act of Congress. List Act § 103(4).

The Department of the Interior publishes its list annually in the Federal Register. The most recent list was published in 73 Fed. Reg. 18,553 (April 4, 2008).

(3) Previous Revenue Procedures. The Internal Revenue Service has issued three

revenue procedures listing Indian tribal entities recognized as Indian tribal governments for purposes of section 7701(a)(40). *See* Rev. Proc. 83–87, 1983–2 C.B. 606; Rev. Proc. 2001–15, 2001–1 C.B. 465; Rev. Proc. 2002–64, 2002–2 C.B. 717. For each of the 2001 and 2002 revenue procedures, the Indian tribal entities listed were also the Indian tribes on the most recent annual list published by the Department of the Interior pursuant to the List Act.

SECTION 2. APPLICATION

.01 In general, an Indian tribal entity that appears on the most recent list published by the Department of the Interior in the Federal Register pursuant to the requirements of the List Act is designated an Indian tribal government for purposes of section 7701(a)(40). Tribal entities not appearing on the list that believe they qualify to be recognized as Indian tribes may contact the Office of Federal Acknowledgment in the Department of the Interior for information on how to apply for recognition pursuant to Department of the Interior procedures. Tribal entities not appearing on the list may apply for a ruling on whether they qualify as Indian tribal governments under section 7701(a)(40) pursuant to all applicable rules set forth in the Statement of Procedural Rules (26 CFR Part 601), and guidelines set forth in Rev. Proc. 84–37, 1984–1 C.B. 513, as modified by Rev. Proc. 86–17, 1986–1 C.B. 550, and Rev. Proc. 2008–1, 2008–1 I.R.B. 1.

.02 A tribe that does not appear on the most recent list published by the Department of the Interior in the Federal Register pursuant to the requirements of the List Act will nonetheless be treated as an Indian tribal government for purposes of section 7701(a)(40) if the tribe has been acknowledged as a federally recognized Indian tribe, as stated in a letter from the Department of the Interior.

.03 Qualification as an Indian tribal government does not necessarily establish that a tribe qualifies for a particular tax benefit. For example, when a tribal entity seeks exemption from excise taxes, the entity must be able to demonstrate that the underlying transaction involves the exercise of an essential governmental function of the Indian tribal government. § 7871(b).

SECTION 3. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–64 is superseded.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective on the date of publication.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Carol Cook of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue procedure, contact Ms. Cook at (202) 622–1124 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Rules for Home Construction Contracts

REG–120844–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations amending the regulations under §1.460 to provide guidance to taxpayers in the home construction industry regarding accounting for certain long-term construction contracts that qualify as home construction contracts under section 460(e)(6) of the Internal Revenue Code (Code) and to provide guidance to taxpayers with long-term contracts under section 460(f) regarding certain changes in method of accounting for long-term contracts. This document also provides a notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by November 3, 2008. Outlines of topics to be discussed at the public hearing scheduled for December 5, 2008, at 10:00 a.m. must be received by November 13, 2008.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–120844–07), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–120844–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–120844–07). The public hearing will be held in the auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Brendan P. O'Hara, (202) 622–4920; concerning submission of comments, the hearing, or to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains a proposed amendment to the Income Tax Regulations, 26 CFR Part 1, under section 460 and §§1.460–3, 1.460–4, 1.460–5 and 1.460–6 of the Income Tax Regulations. In general, section 460(a) requires taxpayers to use the percentage of completion method (PCM) to account for taxable income from any long-term contract. Section 460(e) exempts home construction contracts from the general requirement to use the percentage of completion method of accounting. Section 460(e)(6) defines a home construction contract to be any construction contract if 80 percent or more of the total estimated contract costs are reasonably expected to be attributable to the construction of (i) dwelling units contained in buildings containing 4 or fewer dwelling units, and (ii) improvements to real property directly related to such dwelling units and located on the site of such dwelling units. Section 460(e)(4) defines a construction contract to be any contract for the building, construction, reconstruction, or rehabilitation of, or the installation of any integral component to, or improvement of, real property.

These proposed regulations expand the types of contracts eligible for the home construction contract exemption and amend the rules for how taxpayer-initiated changes in methods of accounting to comply with the regulations under section 460 may be implemented.

Definition of a Home Construction Contract

Improvements to real property

The definition of a *construction contract* under section 460(e) includes many transactions involving land developers and construction service providers in the home construction industry. For example, a construction contract under section 460(e) includes a contract for the provision of land by the taxpayer if the estimated total allocable contract costs attributable to the taxpayer's construction activities (not including the cost of the land provided to the customer) are 10 percent or more of the contract's total contract price.

As noted, section 460(a) requires that the income from any long-term contract be recognized using the percentage of completion method. However, taxpayers with contracts that meet the definition of a "home construction contract" are not required to use the percentage of completion method for those contracts and may use an exempt method. Exempt methods commonly used to account for home construction contracts include the completed contract method (CCM) and the accrual method.

Under section 460, a home construction contract includes any construction contract if 80 percent of the total estimated contract costs are reasonably expected to be attributable to the construction of improvements to real property directly related to qualifying dwelling units and located on the site of such dwelling units. Commentators have suggested that many contracts entered into by land developers in the home construction industry should fall within the definition of a home construction contract.

The proposed regulations expand the scope of the home construction contract exemption by providing that a contract for the construction of common improvements is considered a contract for the construction of improvements to real property directly related to the dwelling unit(s) and located on the site of such dwelling unit(s), even if the contract is not for the construction of any dwelling unit. Therefore, under the proposed regulations, a land developer that is selling individual lots (and its contractors and subcontractors) may

have long-term construction contracts that qualify for the home construction contract exemption.

Townhouses, rowhouses, and condominiums

Under section 460, a home construction contract also includes any construction contract if 80 percent of the total contract costs are reasonably expected to be attributable to the construction of dwelling units contained in buildings containing four or fewer dwelling units. Section 460(e)(6) states that each townhouse or rowhouse shall be treated as a separate building, regardless of the number of townhouses or rowhouses physically attached to each other. In certain circumstances, the terms condominium and townhouse are used interchangeably to describe similar structures. Individual condominium units possess many of the characteristics generally associated with townhouses and rowhouses such as private ownership, shared portions of their structures, residential housing, and the economics of the underlying purchase transactions.

The proposed regulations expand what is considered a townhouse or rowhouse, for purposes of the home construction contract exemption, to include an individual condominium unit. This will have the effect of allowing each condominium unit to be treated as a separate building for purposes of determining whether the underlying contract qualifies as a home construction contract.

Completed contract method

Under the current regulations under section 460, the appropriate severing of a home construction contract requires a facts and circumstances analysis based upon certain factors that are neither specific nor always relevant to home construction contracts. Likewise, the date a home construction contract is considered completed and accepted is determined using a facts and circumstances analysis.

The IRS and Treasury Department are aware of controversies related to the application of the existing facts and circumstances analyses for determining the appropriate severance and final completion and acceptance of home construction contracts accounted for using the completed contract method. Expanding the definition of a home construction contract as provided in these proposed regulations may heighten the significance of these issues. As a result, the IRS and Treasury Department expect to propose specific severing and completion rules for home construction contracts accounted for using the completed contract method. Taxpayers are encouraged to submit comments on the types of severing and completion rules that would result in the clear reflection of income for home construction contracts accounted for using the completed contract method. Specifically, the IRS and the Treasury Department request comments on the circumstances (if any) in which it would not be appropriate to require severing and completion of a home construction contract to be determined on a dwelling unit by dwelling unit or lot by lot basis or, when a contract is not for the sale of a dwelling unit or lot, on the basis of when the taxpayer receives payment(s) under the contract.

Method of accounting

Currently, the regulations under section 460 provide that a taxpayer that uses the percentage-of-completion method (PCM), the exempt-contract percentage-of-completion method (EPCM), or elects the 10-percent method or special alternative minimum taxable income (AMTI) method, or that adopts or elects a cost allocation method of accounting (or changes to another method of accounting with the Commissioner's consent) must apply the method(s) consistently for all similarly classified contracts until the taxpayer obtains the Commissioner's consent under section 446 to change to another method of accounting. The regulations further provide that a taxpayer-initiated change in method of accounting will be permitted only on a cut-off basis (that is, for contracts entered into on or after the year of change), and thus, a section 481(a) adjustment will not be permitted nor required. The proposed regulations continue this cut-off method of implementation but only for taxpayer-initiated changes from a permissible PCM method to another permissible PCM method for long-term contracts for which PCM is required and for taxpayer-initiated changes from a cost allocation method of accounting that complies with the cost allocation rules of §1.460–5 to another cost allocation method of accounting that complies with the cost allocation rules of §1.460–5. Under the proposed regulations all other taxpayer-initiated changes in method of accounting under section 460 will be made with a section 481(a) adjustment.

The proposed regulations provide that in determining the hypothetical underpayment or overpayment of tax for any year as part of the look-back computation, amounts reported as section 481(a) adjustments shall generally be taken into account in the tax year or years they are reported. For purposes of determining whether there is a hypothetical underpayment or overpayment of tax under the look-back computation, a taxpayer would use amounts reported under its old method for the years the old method was used and would use amounts reported under its new method for the years the new method was used, netted against the amount of any section 481(a) adjustments required to be taken into account. Thus, a look-back computation would not be required upon contract completion simply because the taxpayer has changed its method of accounting. However, a look-back computation would be required upon contract completion if actual costs or the contract price differ from the estimated amounts notwithstanding the fact a change in method of accounting occurred. For example, if a taxpayer using PCM changed its method of accounting for construction costs incurred in a contract reported under PCM, the section 460 look-back would be computed using the costs recognized prior to the year of change (reported under the taxpayer's old method of accounting) and the costs recognized in subsequent years using the new method of accounting, netted against any applicable section 481(a) adjustment. Similarly, for changes in methods of accounting where no costs were recognized under the old method of accounting (for example, a change in method of accounting from CCM to PCM), look-back would effectively only apply to years in which the taxpayer's new method of accounting was used to the extent that no costs were recognized prior to the year of change under the old method of accounting. This approach to the look-back computation is consistent with the underlying purpose of look-back as well as the general accounting method

change procedures. Comments are specifically requested with respect to issues that taxpayers may foresee with respect to the rules provided in these proposed regulations for taking into account section 481(a) adjustments in the year reported for purposes of the look-back computation.

Proposed Effective/Applicability Date

These regulations are proposed to apply to taxable years beginning on or after the date the final regulations are published in the **Federal Register**. The final regulations will provide rules applicable to taxpayers that seek to change a method of accounting to comply with the rules contained in the final regulations. Taxpayers may not change or otherwise use a method of accounting in reliance upon the rules contained in these new proposed regulations until the rules are published as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this proposed regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original with eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for December 5, 2008, beginning at 10:00 a.m., in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by November 13, 2008. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Brendan P. O'Hara, Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.460–3 is amended by:

1. Revising paragraph (b)(1)(ii).

2. Redesignating paragraphs (b)(2)(ii), (b)(2)(iii) and (b)(2)(iv) as paragraphs (b)(2)(iii), (b)(2)(iv) and (b)(2)(v), respectively, and revising them.

3. Adding a new paragraph (b)(2)(ii).

The revisions and addition read as follows:

§1.460–3 Long-term construction contracts.

* * * * *

(b) * * *

(1) * * *

(ii) Construction contract, other than a home construction contract, that a taxpayer estimates (when entering into the contract) will be completed within 2 years of the contract commencement date, provided the taxpayer satisfies the $10,000,000 gross receipts test described in paragraph (b)(3) of this section.

(2) * * *

(ii) *Land improvements*. For purposes of paragraph (b)(2)(i)(B) of this section, improvements to real property directly related to, and located on the site of, the dwelling units consist of improvements to land on which dwelling units (as described in paragraph (b)(2)(i)(A) of this section) are constructed, and common improvements as defined in paragraph (b)(2)(iv) of this section. A long-term construction contract is a home construction contract if a taxpayer (including a subcontractor working for a general contractor) meets the 80% test in paragraph (b)(2)(i) of this section as applied to either paragraph (b)(2)(i)(A) of this section or paragraph (b)(2)(i)(B) of this section, or both paragraphs (b)(2)(i)(A) and (b)(2)(i)(B) of this section, collectively.

(iii) *Townhouses and rowhouses*. For purposes of determining whether a long-term construction contract is a home construction contract under paragraph (b)(2) of this section, each townhouse or rowhouse is a separate building. For this purpose, the term townhouse and rowhouse includes an individual condominium unit.

(iv) *Common improvements*—(A) *In general*. A taxpayer includes in the cost of a dwelling unit or land its allocable share of the cost that the taxpayer incurs for any common improvements that benefit the dwelling unit or land.

(B) *Definition*. For purposes of this section, *a common improvement* is an improvement that the taxpayer is contractually obligated, or required by law, to construct within the tract or tracts of land containing the dwelling units (or the land on which dwelling units are to be constructed)

and that benefits the dwelling units (or the land on which dwelling units are to be constructed). In general, a common improvement does not solely benefit any particular dwelling unit or any particular lot on which a dwelling unit is constructed. However, land clearing and grading are common improvements, even when performed on a particular lot. Other examples of common improvements are sidewalks, sewers, roads and clubhouses.

(v) *Mixed use costs*. If a contract involves the construction of both commercial units and dwelling units, a taxpayer must allocate the costs among the commercial units and dwelling units using a reasonable method or combination of reasonable methods. In general, the reasonableness of an allocation method will be based on facts and circumstances. Examples of methods that may be reasonable are specific identification, square footage, or fair market value.

* * * * *

Par. 3. Section 1.460–4 is amended by:

1. Revising the third sentence in paragraph (c)(1).

2. Redesignating paragraph (g) as paragraph (g)(1) and revising newly redesignated paragraph (g)(1).

3. Adding a paragraph (g)(2).

4. Revising *Example 5*. of paragraph (h).

The revisions and additions read as follows:

§1.460–4 Methods of accounting for long-term contracts.

* * * * *

(c) * * *

(1) * * * Permissible exempt contract methods are the PCM, the EPCM described in paragraph (c)(2) of this section, the CCM described in paragraph (d) of this section, the accrual method, and any other permissible method. * * *

* * * * *

(g) *Method of accounting*—(1) *In general*. A taxpayer must apply its method(s) of accounting for long-term contracts consistently for all similarly classified long-term contracts until the taxpayer obtains the Commissioner's consent under section 446(e) to change to another method of accounting.

(2) *Taxpayer-initiated change in method of accounting*—(i) *Change to PCM for long-term contracts for which PCM is required*. A taxpayer-initiated change in method of accounting for long-term contracts (or portion thereof) for which income must be determined using the PCM described in paragraph (b) of this section and the costs allocation rules described in §1.460–5(b) or (c) (required PCM contracts) from a method of accounting that does not comply with paragraph (b) of this section and §1.460–5(b) or (c) to a method that complies with paragraph (b) of this section and §1.460–5(b) or (c) must be applied to all required PCM contracts entered into before the year of change and not reported as completed as of the beginning of the year of change. Accordingly, a section 481(a) adjustment will be required.

(ii) *Change from a permissible PCM method to another permissible PCM method for long-term contracts for which PCM is required*. A taxpayer initiated change in method of accounting for required PCM contracts, as defined in paragraph (g)(2)(i) of this section (or a portion thereof), from a method of accounting that complies with paragraph (b) of this section and §1.460–5(b) or (c) to another method of accounting that complies with paragraph (b) of this section and §1.460–5(b) or (c) must be made on a cut-off basis and applied only to contracts entered into during and after the year of change. Accordingly, a section 481(a) adjustment will be neither permitted nor required.

(iii) *Change to an exempt contract method for home construction contracts*. A taxpayer-initiated change in method of accounting for home construction contracts, as defined in §1.460–3(b)(2), to a permissible exempt contract method, as described in paragraph (c)(1) of this section, must be applied to all home construction contracts entered into before the year of change and not reported as completed as of the beginning of the year of change. Accordingly, a section 481(a) adjustment will be required.

(iv) *Change to an exempt contract method for exempt contracts other than home construction contracts*. A taxpayer-initiated change in method of accounting for long-term contracts (or portion thereof) not described in paragraphs (g)(2)(i), (ii) and (iii) of this section to a permissible exempt contract method as described in paragraph (c)(1) of this section must be applied to all contracts that are eligible to use the exempt contract method entered into before the year of change and not reported as completed as of the beginning of the year of change. Accordingly, a section 481(a) adjustment will be required.

(h) * * *

* * * * *

Example 5. PCM—contract terminated. C, whose taxable year ends December 31, determines the income from long-term contracts using the PCM. During 2001, C buys land and begins constructing a building that will contain 50 apartment units on that land. C enters into a contract to sell the building to B for $2,400,000. B gives C a $50,000 deposit toward the purchase price. By the end of 2001, C has incurred $500,000 of allocable contract costs on the building and estimates that the total allocable contract costs on the building will be $1,500,000. Thus, for 2001, C reports gross receipts of $800,000 ($500,000 / $1,500,000 x $2,400,000), current-year costs of $500,000, and gross income of $300,000 ($800,000 - $500,000). In 2002, after C has incurred an additional $250,000 of allocable contract costs on the building, B files for bankruptcy protection and defaults on the contract with C, who is permitted to keep B's $50,000 deposit as liquidated damages. In 2002, C reverses the transaction with B under paragraph (b)(7) of this section and reports a loss of $300,000 ($500,000 - $800,000). In addition, C obtains an adjusted basis in the building sold to B of $700,000 ($500,000 (current-year costs deducted in 2001) - $50,000 (B's forfeited deposit) + $250,000 (current-year costs incurred in 2002). C may not apply the look-back method to this contract in 2002.

* * * * *

Par. 4. Section 1.460–5 is amended by:

1. Adding a new sentence to the end of paragraph (c)(2).

2. Revising paragraph (g).

The revision and addition read as follows:

§1.460–5 Cost allocation rules.

* * * * *

(c) * * *

(2) * * * Further, this election is not available if a taxpayer is changing from a cost allocation method other than as prescribed in paragraph (b) of this section, in which case the taxpayer must follow the procedures under §1.446–1(e) for obtaining the Commissioner's consent for the change in method of accounting.

* * * * *

(g) *Method of accounting*. A taxpayer that adopts, elects, or otherwise changes

to a cost allocation method of accounting (or changes to another cost allocation method of accounting with the Commissioner's consent) must apply that method consistently for all similarly classified contracts, until the taxpayer obtains the Commissioner's consent under section 446 to change to another cost allocation method. A taxpayer-initiated change in cost allocation method from a method that does not comply with the cost allocation rules of this section to a method that complies with the cost allocation rules of this section must be applied to all long-term contracts to which the rules of this section apply, including contracts entered into before the year of change and not reported as completed as of the beginning of the year of change. Accordingly, a section 481(a) adjustment is required. Any other taxpayer-initiated change in cost allocation method to a method permitted under the rules of this section must be made on a cut-off basis and applied only to contracts entered into during and after the year of change, in which case a section 481(a) adjustment will be neither permitted nor required.

Par. 5. Section 1.460–6 is amended by:

1. Adding paragraph (c)(3)(vii).

2. Redesignating paragraph (d)(2)(iv) as paragraph (d)(2)(v).

3. Adding a new paragraph (d)(2)(iv).

The additions and revision read as follows:

§1.460–6 Look-back method.

* * * * *

(c) * * *

(3) * * *

(vii) *Section 481(a) adjustments*. For purposes of determining the hypothetical underpayment or overpayment of tax for any year, amounts reported as section 481(a) adjustments shall be taken into account in the tax year or years they are reported. However, any portion of a section 481(a) adjustment not yet reported as of the tax year in which the contract is completed shall be taken into account in the tax year the contract is completed for purposes of determining the hypothetical underpayment or overpayment of tax.

* * * * *

(d) * * *

(2) * * *

(iv) *Section 481(a) adjustments*. For purposes of determining the hypothetical underpayment or overpayment of tax for any year under the simplified marginal impact method, amounts reported as section 481(a) adjustments shall be taken into account in the tax year or years they are reported. However, any portion of a section 481(a) adjustment not yet reported as of the tax year in which the contract is completed shall be taken into account in the tax year the contract is completed for purposes of determining the hypothetical underpayment or overpayment of tax.

* * * * *

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 1, 2008, 8:45 a.m., and published in the issue of the Federal Register for August 4, 2008, 73 F.R. 45180)

Notice of Proposed Rulemaking

Employee Stock Purchase Plans Under Internal Revenue Code Section 423

REG–106251–08

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to options granted under an employee stock purchase plan as defined in section 423 of the Internal Revenue Code (Code). These proposed regulations affect certain taxpayers who participate in the transfer of stock pursuant to the exercise of options granted under an employee stock purchase plan. These proposed regulations provide guidance to assist taxpayers in complying with section 423 in addition to clarifying certain rules regarding options granted under an employee stock purchase plan. This document also contains proposed regulations under sections 421 and 422 of the Code.

DATES: Written or electronic comments must be received by October 27, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–106251–08), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–106251–08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS REG–106251–08).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Thomas Scholz at (202) 622–6030; concerning submissions of comments, and/or to request a hearing, Oluwafunmilayo Taylor, at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under section 423 of the Code. This document also contains minor proposed amendments to 26 CFR part 1 under sections 421 and 422 of the Code.

Section 423 was added to the Code by section 221(a) of the Revenue Act of 1964, Public Law 88–272 (78 Stat. 63 (1964)). Changes to the applicable law concerning section 423 were made by sections 1402(b)(1)(C) and 1402(b)(2) of the Tax Reform Act of 1976, Public Law 94–455 (90 Stat. 1731 and 1732–1733 (1976)); section 1001(b)(5) of the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 1011 (1984)); section 1114 of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2451 (1986)); and sections 11801(c)(9)(D)(i)-(ii) and 11801(c)(9)(E) of the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388–525 (1990)).

Regulations under section 423 were published in the **Federal Register** on June 23, 1966 (T.D. 6887, 1966–2 C.B. 129). These regulations were amended on September 27, 1979 (T.D. 7645, 1979–2 C.B. 198), October 31, 1980 (T.D. 7728, 1980–2 C.B. 236), and December 1, 1988 (T.D. 8235, 1989–1 C.B. 117). In Notice 2004–55, 2004–2 C.B. 319 (August 23,

2004), (see §601.601(d)(2)(ii)(*b*)), the IRS and the Treasury Department requested comments concerning whether the existing regulations under section 423 should be amended, and if so, what issues should be addressed. Two comment letters were submitted in response to Notice 2005–55 and the suggestions in those letters are addressed in this preamble.

In general, the income tax treatment of the grant of an option to purchase stock in connection with the performance of services and of the transfer of stock pursuant to the exercise of the option is determined under section 83 and the regulations thereunder. However, section 421 provides special rules for determining the income tax treatment of the transfer of shares of stock pursuant to the exercise of an option if the requirements of sections 422(a) or 423(a), as applicable, are met. Section 422 applies to incentive stock options and section 423 applies to options granted under an employee stock purchase plan (collectively, statutory options).

Under section 421, if a share of stock is transferred to an individual pursuant to the exercise of a statutory option, there is no income at the time of exercise of the option with respect to the transfer and no deduction under section 162 is allowed to the employer corporation with respect to the transfer.

Section 423(a) provides that section 421 applies to the transfer of stock to an individual pursuant to the exercise of an option granted under an employee stock purchase plan if: (i) no disposition of the stock is made within two years from the date of grant of the option or within one year from the date of transfer of the share, and (ii) at all times during the period beginning on the date of grant and ending on the day three months before the exercise of the option, the individual is an employee of either the corporation granting the option or a parent or subsidiary of such corporation, or a corporation (or a parent or subsidiary of such corporation) issuing or assuming a stock option in a transaction to which section 424(a) applies. Section 423(b) sets forth several requirements that must be met for a plan to qualify as an employee stock purchase plan. Section 423(c) provides a special rule that is applicable where the option exercise price is between 85 and 100 percent of the fair market value of the stock at the time the option was granted.

Section 424 provides special rules applicable to statutory options, including rules concerning the modification of statutory options and the substitution or assumption of an option by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation. Section 424 also contains definitions of certain terms, including disposition, parent corporation, and subsidiary corporation. Finally, section 424 provides special rules related to attribution of stock ownership and the effect of stockholder approval on the date of grant of a statutory option.

Explanation of Provisions

These proposed regulations would provide a comprehensive set of rules governing stock options issued under an employee stock purchase plan and would incorporate substantially all of the rules contained in the existing regulations under section 423. These proposed regulations are comprised of two sections: Section 1.423–1, applicability of section 421(a); and §1.423–2, employee stock purchase plan defined. These proposed regulations would amend the existing regulations under section 423 in several ways. First, these proposed regulations would update the existing regulations to incorporate statutory changes and to make them consistent, where appropriate, with the regulations under section 422 related to incentive stock options. The regulations under section 422 were last updated in 2004. See T.D. 9144, 2004–2 C.B. 413. Second, these proposed regulations would update the existing regulations to provide additional guidance in certain areas as discussed below. Finally, these proposed regulations would also update the existing regulations to remove obsolete rules.

1. General requirements

Under §1.423–2(a)(1) of these proposed regulations, an employee stock purchase plan must meet the requirements of paragraphs (i) through (ix) of §1.423–2(a)(2). The terms of the plan, or an offering under the plan, must satisfy the requirements of paragraphs (iii) through (ix) of §1.423–2(a)(2). Consistent with §1.422–2(b)(1), §1.423–2(a)(1) of these proposed regulations would provide that the plan and the terms of an offering must be in writing or electronic form, provided that such writing or electronic form is adequate to establish the terms of the plan or offering.

Section 1.423–2(a)(2) of these proposed regulations lists the requirements that must be met for qualification as an employee stock purchase plan and provides cross references to the specific section of these regulations that addresses each requirement.

Under §1.423–2(a)(3) of these proposed regulations, if the terms of an option are inconsistent with the terms of the employee stock purchase plan or an offering under the plan, then the option will not be treated as granted under an employee stock purchase plan. (Section 1.423–2(a)(2) of the existing regulations has been re-numbered as §1.423–2(a)(3) of these proposed regulations.) If an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an employee who is entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under the offering that qualifies as an option granted under an employee stock purchase plan, then the offering will not meet the requirements of §1.423–2(e) of these proposed regulations, which generally requires that options be granted to all employees of any corporation whose employees are granted options under an employee stock purchase plan. As a result, none of the options granted under the offering will be eligible for the special tax treatment of section 421. *Example 1* in §1.423–2(a)(4) illustrates this principle. Section 1.423–2(a)(4) of these proposed regulations contains additional examples to illustrate the principles of §1.423–2(a)(3).

If an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an individual who is not entitled to the grant of an option under the terms of the plan or offering, then the option will not be treated as an option granted under an employee stock purchase plan, and the grant of the option will not disqualify the options granted under the offering. *Examples 2 and 3* in §1.423–2(a)(4) of these proposed regulations illustrate this principle.

If, at the time of grant, an option qualifies as an option granted under an employee stock purchase plan, but the terms of the option are not satisfied, then the option will not be treated as granted under an employee stock purchase plan. However, this failure to comply with the terms of the option will not disqualify the options granted under the plan or offering. *Example 4* in §1.423–2(a)(4) of these proposed regulations illustrates this principle.

2. Stockholder approval of the employee stock purchase plan

To qualify as an employee stock purchase plan, section 423(b)(2) requires that the plan be approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted. These proposed regulations would provide the same basic requirements for stockholder approval as those included in the existing regulations. Consistent with §1.422–2(b)(2), these proposed regulations would provide additional guidance concerning the circumstances under which stockholder approval is required.

These proposed regulations, like the existing regulations, would require stockholder approval if there is a change in the aggregate number of shares or in the employees eligible to be granted options under the plan. The standard for determining when stockholder approval is required under these proposed regulations generally is the same as under the existing regulations. These proposed regulations would clarify the requirements for stockholder approval and would provide a more comprehensive list of situations that require new stockholder approval of the plan. In particular, these proposed regulations would clarify that new stockholder approval is required if there is a change in the shares with respect to which options are issued or a change in the granting corporation.

For example, assume that S, a wholly owned subsidiary of P, adopts an employee stock purchase plan under which options for S stock will be granted to S employees, and the plan is approved by the stockholder of S (in this case, P) within the applicable 24-month period. If S later amends the plan to provide for the grant of options to acquire P stock (rather than S stock), S must obtain approval from the stockholders of S (in this case, P) within 12 months before or after the date of the amendment of the plan because the amendment of the plan to allow the grant of options for P stock is considered the adoption of a new plan. See paragraph (iii) of *Example 1* in §1.423–2(c)(5) of these proposed regulations. This conclusion differs from that in paragraph (iii) of *Example 1* under §1.422–2(b)(6), which concludes that the stockholders of P rather than the stockholders of S must approve the plan as a result of its amendment to provide for the grant of options to acquire P stock. The IRS and the Treasury Department invite comment on this result and are proposing a conforming change to *Example 1*, paragraph (iii) under §1.422–2(b)(6).

These proposed regulations also would provide additional guidance regarding the application of the stockholder approval requirements where an employee stock purchase plan is assumed in connection with a corporate transaction. *Example 3* in §1.423–2(c)(5) of these proposed regulations illustrates this principle.

3. Maximum aggregate number of shares

Section 1.423–2(c)(3) of the existing regulations provides that an employee stock purchase plan must designate the maximum aggregate number of shares that may be issued under the plan. Consistent with §1.422–2(b)(3)(ii), these proposed regulations would provide that the plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued, or outstanding shares at the date of the adoption of the plan. Further, a plan providing that the maximum aggregate number of shares issued subject to options under the plan may change based on any other specific circumstances will satisfy the requirements of §1.423–2(c)(3) only if the stockholders approve an immediately determinable maximum number of shares that may be issued under the plan in any event. *Examples 4 and 5* in §1.423–2(c)(5) of these proposed regulations illustrate these principles.

4. Employees covered by the plan

Section 423(b)(4) permits an employer to exclude from participation one or more of the following categories of employees: Employees who have been employed less than two years; Employees who customarily work 20 hours or less per week; Employees who customarily work not more than five months in any calendar year; and Highly compensated employees (HCEs) within the meaning of section 414(q). Section 1.423–1(e)(1) of these proposed regulations has been updated to reflect the 1986 amendment of section 423(b)(4)(D) to substitute "highly compensated employees (within the meaning of section 414(q))" for "officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees." See Public Law 99–514, section 1114(b)(13).

One commentator suggested that the regulations clarify that an employer may exclude from participation a subset of one of the groups set forth in section 423(b)(4). For example, an employer should be permitted to exclude a subset of HCEs, such as officers, from participation in the plan. The commentator further suggested that the regulations clarify that an employer may impose shorter service requirements than those permitted. For example, an employer should be permitted to exclude employees who have been employed less than one year from participation in the plan.

The IRS and the Treasury Department agree that a more inclusive application of the rules of section 423(b)(4) is consistent with the intent of section 423. Accordingly, §1.423–2(e)(2) of these proposed regulations would provide that an employee stock purchase plan does not fail to satisfy the coverage provision of section 423(b)(4) merely because the plan excludes employees who have completed a shorter period of service or whose customary employment is for fewer hours per week or fewer months in a calendar year than is specified in subparts (A), (B) and (C) of section 423(b)(4), provided the exclusion is applied in an identical manner to all employees of every corporation whose employees are granted options under the plan. In addition, these proposed regulations would provide that the terms of an employee stock purchase plan may exclude HCEs: (a) with compensation above a certain level, or (b) who are officers or subject to the disclosure requirements of section 16(a) of the Securities Exchange

Act of 1934, provided the exclusion is applied in an identical manner to all HCEs of every corporation whose employees are granted options under the plan. *Examples 3, 4, 5, 6, and 7* in §1.423–2(e)(6) of these proposed regulations illustrate these principles. (The examples under §1.423–2(e)(3) of the existing regulations have been re-numbered as §1.423–2(e)(6) of these proposed regulations.)

Another commentator suggested that the regulations permit employers to exclude from plan participation employees who are nonresident aliens and who receive no earned income that constitutes income from sources within the United States. The IRS and the Treasury Department agree that it may be appropriate to exclude foreign employees from plan participation in certain limited circumstances. However, unlike section 410(b), section 423 does not provide an exclusion for such nonresident aliens. Accordingly, the IRS and the Treasury Department are constrained by statutory authority from providing a general exclusion from plan participation for employees who are nonresident aliens and who receive no United States source income. Therefore, §1.423–2(e)(3) of these proposed regulations would provide that employees who are citizens or residents of a foreign jurisdiction (without regard to whether they are also citizens of the United States or resident aliens (within the meaning of §7701(b)(1)(A))) may be excluded from the coverage of an employee stock purchase plan only if the grant of an option under the plan to a citizen or resident of the foreign jurisdiction is prohibited under the laws of such jurisdiction or if compliance with the laws of the foreign jurisdiction would cause the plan to violate the requirements of section 423. *Example 8* in §1.423–2(e)(6) of these proposed regulations illustrates this principle.

Another commentator suggested that the regulations permit employers to exclude collectively bargained employees from plan participation. However, unlike section 410(b), section 423 does not provide an exclusion for collectively bargained employees. Accordingly, the IRS and the Treasury Department are again constrained by statutory authority from providing a general exclusion from plan participation for collectively bargained employees.

One commentator suggested that the regulations be amended to provide that an offering will not lose its tax-favored status due to the inadvertent exclusion of employees from plan participation. Rather, the commentator suggested that the granting corporation be permitted to correct certain errors in plan administration through a corrections program that would permit the excluded employees to participate in past offerings under a plan. Such a corrections program is beyond the scope of these regulations. However, the IRS and the Treasury Department invite comments on whether such a program is appropriate (including the statutory authority for such a program) and suggestions for the types of violations that might be covered and the methods of correction.

Section 1.423–2(e)(4) of these proposed regulations includes language that appears under §1.423–2(e)(1) of the existing regulations. Section 1.423–2(e)(2) of the existing regulations has been re-numbered as §1.423–2(e)(5) of these proposed regulations.

5. Equal rights and privileges

Section 423(b)(5) requires that, subject to certain exceptions, an employee stock purchase plan, by its terms, provide that all employees granted options under the plan have the same rights and privileges.

Section 1.423–2(f)(3) of these proposed regulations includes language that appears in §1.423–2(f)(1) of the existing regulations. (The examples in §1.423–2(f)(2) of the existing regulations have been relocated to *Examples 1 and 2* of §1.423–2(f)(7) of these proposed regulations. The example in §1.423–2(f)(4) of the existing regulations has been relocated to *Example 3* of §1.423–2(f)(7). Section 1.423–2(f)(4) of the existing regulations is re-numbered under these proposed regulations as §1.423–2(f)(6)).

One commentator suggested that a plan or offering should not fail to satisfy the equal rights and privileges provision of section 423(b)(5) if the provisions of the plan or offering applied to foreign employees are reasonably designed to avoid adverse consequences for such employee under foreign law as a result of plan participation. The IRS and the Treasury Department agree that in certain limited circumstances it may be appropriate for the terms of an employee stock purchase plan to be less favorable with respect to foreign employees than those terms are with respect to employees resident in the United States. Accordingly, §1.423–2(f)(4) of these proposed regulations would provide that a plan or offering will not fail to satisfy the requirements of section 423(b)(5) if, in order to comply with the laws of a foreign jurisdiction, the terms of an option granted under a plan or offering to citizens or residents of such foreign jurisdiction (without regard to whether they are also citizens of the United States or resident aliens (within the meaning of §7701(b)(1)(A))) are less favorable than the terms of options granted under the same plan or offering to employees resident in the United States. *Example 4* in §1.423–2(f)(7) of these proposed regulations illustrates this principle.

A plan or offering will not satisfy the requirements of section 423(b)(5), however, if, in order to comply with the laws of a foreign jurisdiction, the terms of the plan or offering are more favorable with respect to citizens or residents of such foreign jurisdiction than the terms of the plan or offering are with respect to employees resident in the United States.

Another commentator suggested that the regulations addressing the carryover of amounts from one offering to another be clarified. In response to this comment, these proposed regulations would clarify §1.423–2(f)(3) of the existing regulations (which has been re-numbered as §1.423–2(f)(5)). Generally, a plan permitting one or more employees to carry forward amounts that were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply such amounts toward the purchase of additional stock under a subsequent plan or offering will be a violation of the equal rights and privileges requirement under section 423(b)(5). However, the carry forward of amounts withheld but not applied toward the purchase of stock under an earlier plan or offering will not violate the equal rights and privileges requirement of section 423(b)(5) if all other employees participating in the current plan or offering are permitted to make direct payments toward the purchase of shares under a subsequent plan or offering in an amount equal to the excess of: (a) the greatest amount that any employee is allowed to carry forward from an earlier

plan or offering over (b) the amount, if any, the employee will carry forward from an earlier plan or offering. *Example 5* in §1.423–2(f)(7) of these proposed regulations illustrates this principle.

Further, a plan will not fail to satisfy the equal rights and privileges requirement of section 423(b)(5) merely because employees are permitted to carry forward amounts representing a fractional share which were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply such amounts toward the purchase of additional stock under a subsequent plan or offering.

6. Option price

Under section 423(b)(6), the option price must not be less than the lesser of: (a) an amount equal to 85 percent of the fair market value of the stock at the time the option is granted, and (b) an amount not less than 85 percent of the fair market value of the stock at the time the option is exercised. Consistent with §1.422–2(e)(1), §1.423–2(g)(1) of these proposed regulations would provide that the option price may be determined in any reasonable manner, including the valuation methods permitted under §20.2031–2 (Estate Tax Regulations), so long as the option price meets the minimum pricing requirements of section 423(b)(6).

7. Date of grant

Section 1.421–1(c) provides, that for purposes of §§1.421–2 through 1.424–1, the language "the date of the granting of the option" and "the time such option is granted" and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. The date of grant for an option granted under an employee stock purchase plan is important for several reasons. First, the favorable tax consequences under section 421 apply to the shares acquired pursuant to the exercise of an option granted under an employee stock purchase plan if the shares are not disposed of within two years from the date of grant of the option or within one year from the date of exercise of the option. Second, the $25,000 limitation under section 423(b)(8) is determined based on the fair market value of the stock measured on the date of grant of the option. The date of grant is also important for purposes of determining the employees eligible to participate in the plan and, in certain cases, determining the purchase price of stock under the plan.

Section 1.421–1(c) further provides that a corporate action constituting an offer of stock for sale is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum option price are fixed or determinable. Because options under an employee stock purchase plan may be priced at the lesser of an amount equal to 85 percent of the fair market value of the stock at the time the option is granted, and an amount not less than 85 percent of the fair market value of the stock at the time the option is exercised, it is not always possible to determine the minimum option price on the first day of an offering. However, many granting corporations intend for the first day of an offering to be the date of grant.

Accordingly, §1.423–2(h)(2) of these proposed regulations would provide that, for purposes of options granted under an employee stock purchase plan, the principles of §1.421–1(c) shall be applied without regard to the requirement that the minimum option price be fixed or determinable in order for the corporate action constituting an offer of stock to be considered complete. As a result, the first day of an offering could be the date of grant for an option issued under an employee stock purchase plan even though the minimum option price is not fixed or determinable on the first day of the offering. These proposed regulations include an amendment to §1.421–1(c).

One commentator questioned whether it is necessary for a plan to contain a limit on the number of shares that can be purchased by each participant during an offering in order for the date of grant of the option to be the first day of an offering. Section 1.423–2(h)(3) of these proposed regulations would provide that the date of grant will be the first day of an offering if the terms of an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each participant during the offering. Similarly, the date of grant will be the first day of an offering if the terms of the plan or offering require the application of a formula to establish, on the first day of the offering, the maximum number of shares that may be purchased by each participant during the offering.

However, §1.423–2(h)(3) of these proposed regulations does not require that an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each participant during the offering or incorporate a formula to establish a maximum number of shares that may be purchased by each participant during the offering. If the maximum number of shares that can be purchased under an option is not fixed or determinable until the date the option is exercised, then the date of exercise will be the date of grant of the option. The $25,000 limit under section 423(b)(8) and the limit on the aggregate number of shares that may be issued under an employee stock purchase plan are not sufficient to establish the maximum number of shares that can be purchased under an option so that the date of grant will be the first day of the offering. *Examples 1, 2, 3 and 4* in §1.423–2(h)(4) of these proposed regulations illustrate these principles.

Section 1.423–2(h) of the existing regulations is re-numbered as §1.423–2(h)(1) of these proposed regulations.

8. Annual $25,000 limitation

Section 423(b)(8) provides that an employee stock purchase plan must, by its terms, provide that no employee may be permitted to purchase stock under all the employee stock purchase plans of his or her employer corporation and its related corporations at a rate which exceeds $25,000 in fair market value of the stock (determined on the date of grant) for each calendar year in which an option granted to the employee is outstanding and exercisable. Section 1.423–2(i) of these proposed regulations would provide guidance on the operation of the $25,000 limitation that incorporates and clarifies the guidance provided in the existing regulations.

One commentator suggested that the calculation of the amount of stock that may be purchased under an employee stock purchase plan be determined in a manner consistent with the $100,000 limitation for incentive stock options described in §1.422–4. The proposed regulations generally adopt this suggestion and would

provide that the $25,000 limit for employee stock purchase plans is, to the extent possible, calculated in a manner consistent with the $100,000 limitation for incentive stock options. The timing of both measures is based on when the option first becomes exercisable and both measures are made based on the fair market value of the stock determined at the date of grant. Section 1.423–2(i) of these proposed regulations emphasizes that an employee may purchase up to $25,000 of stock (based on the fair market value of such stock on the date of grant) in each calendar year during which an option granted to the employee under an employee stock purchase plan is not only outstanding, but also exercisable. *Example 5* in §1.423–2(i)(5) of these proposed regulations illustrates this principle.

For clarification, *Example 1* in §1.423–2(i)(4) of the existing regulations has been separated into *Example 1* and *Example 4* in §1.423–2(i)(5) of these proposed regulations.

9. Special rule where option price is between 85 percent and 100 percent of the value of the stock

Section 423(c) provides a special rule for calculating the timing and amount of compensation income that must be recognized when the option price for a share is between 85 and 100 percent of the value of the share on the date of grant. Generally, the income recognized is the lesser of: (a) the excess of the fair market value of the share on the date of grant over the option price, and (b) the excess of the fair market value of the share at the time of disposition (or death) over the option price. The flush language of section 423(c) provides that if the exercise price is not known on the date of grant, the exercise price shall be determined as if the option were exercised on the date of grant.

One commentator suggested that it is unclear how this special rule and the flush language of section 423(c) apply when the option price is determined based on some percentage of the value of a share on the last day of an offering. *Example 3* of §1.423–2(k)(3) of the existing regulations specifically addresses this issue and has been retained in §1.423–2(k)(3) of these proposed regulations. *Example 4* has been added under §1.423–2(k)(3) to illustrate the tax consequences under an employee stock purchase plan that uses a look-back feature to determine the exercise price of the option.

Proposed Effective Date

These regulations under section 423 are proposed to apply as of January 1, 2010, and will apply to any option issued under an employee stock purchase plan that is granted on or after that date. Taxpayers may rely on these proposed regulations for the treatment of any option issued under an employee stock purchase plan that is granted after publication of these proposed regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Thomas Scholz, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.421–1, paragraphs (c)(1) and (j)(1) are revised to read as follows:

§1.421–1 Meaning and use of certain terms.

* * * * *

(c) *Time and date of granting option*. (1) For purposes of this section and §§1.421–2 through 1.424–1, the language "the date of the granting of the option" and "the time such option is granted," and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. Except as set forth in §1.423–2(h)(2), a corporate action constituting an offer of stock for sale is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum option price are fixed or determinable.

* * * * *

(j) *Effective/applicability date*—(1) *In general*. Except for paragraph (c)(1), these regulations are effective on August 3, 2004. Upon the date of publication of the Treasury decision adopting paragraph (c)(1) of this section as a final regulation in the **Federal Register**, paragraph (c)(1) will apply as of January 1, 2010.

* * * * *

Par. 3. Section 1.422–2, paragraph (b)(6), *Example 1* (iii) is revised to read as follows:

§1.422–2 Incentive stock options defined.

* * * * *

(b) * * *

(6) * * *

Example (1). * * *

(iii) Assume the same facts as in paragraph (i) of this Example 1. Assume further that the plan was approved by the stockholders of S (in this case, P) on March 1, 2006. On January 1, 2008, S changes the plan to provide that incentive stock options for P stock will be granted to S employees under the plan. Because there is a change in the stock available for grant under the plan, the change is considered the adoption of a new plan that must be approved by the stockholder of S (in this case, P) within 12 months before or after January 1, 2008.

* * * * *

Par. 4. Section 1.422–5, paragraph (f)(1) is revised to read as follows:

§1.422–5 Permissible provisions.

* * * * *

(f) *Effective/applicability date*—(1) *In general*. Except for §1.422–2(b)(6), *Example 1* (iii), these regulations are effective on August 3, 2004. Upon the date of publication of the Treasury decision adopting Section 1.422–2(b)(6), *Example 1* (iii) of this section as a final regulation in the **Federal Register**, Section 1.422–2(b)(6), *Example 1* (iii) will apply as of January 1, 2010.

* * * * *

Par. 5. Section 1.423–1 is revised to read as follows:

§1.423–1 Applicability of section 421(a).

(a) *General rule*. Subject to the provisions of section 423(c) and paragraph (k) of §1.423–2, the special rules of income tax treatment provided in section 421(a) apply with respect to the transfer of a share of stock to an individual pursuant to the individual's exercise of an option granted under an employee stock purchase plan if the following conditions are satisfied—

(1) The individual makes no disposition of such share before the later of the expiration of the two-year period from the date of the grant of the option pursuant to which such share was transferred or the expiration of the one-year period from the date of transfer of such share to the individual; and

(2) At all times during the period beginning on the date of the grant of the option and ending on the day three months before the date of exercise, the individual was an employee of the corporation granting the option, a related corporation, or a corporation (or a related corporation) substituting or assuming the stock option in a transaction to which section 424(a) applies.

(b) *Cross-references*. For rules relating to the requisite employment relationship, see paragraph (h) of §1.421–1. For rules relating to the effect of a disqualifying disposition, see section 421(b) and paragraph (b) of §1.421–2. For the definition of the term *disposition*, see section 424(c) and paragraph (c) of §1.424–1. For the definition of the term *related corporation*, see paragraph (i) of §1.421–1.

(c) *Effective/applicability date*. Upon the date of publication of the Treasury decision adopting the rules of this section as a final regulation in the **Federal Register**, these rules will apply as of January 1, 2010.

Par. 6. Section 1.423–2 is revised to read as follows:

§1.423–2 Employee stock purchase plan defined.

(a) *In general*—(1) The term *employee stock purchase plan* means a plan that meets the requirements of paragraph (a)(2)(i) through (ix) of this section. If the terms of the plan do not satisfy the requirements of paragraph (a)(2)(iii) through (ix) of this section, such requirements may be satisfied by the terms of an offering made under the plan. However, where the requirements of paragraph (a)(2)(iii) through (ix) of this section are satisfied by the terms of an offering, such requirements will be treated as satisfied only with respect to options exercised under that offering. The plan and the terms of an offering must be in writing or electronic form, provided that such writing or electronic form is adequate to establish the terms of the plan or offering, as applicable.

(2) To qualify as an employee stock purchase plan under this section and §1.423–1, the plan must meet all of the following requirements—

(i) The plan must provide that options can be granted only to employees of the employer corporation or of a related corporation (as defined in paragraph (i) of §1.421–1) to purchase stock in any such corporation (see paragraph (b) of this section);

(ii) The plan must be approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted (see paragraph (c) of this section);

(iii) Under the terms of the plan, an employee cannot be granted an option if, immediately after the option is granted, the employee owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of a related corporation (see paragraph (d) of this section);

(iv) Under the terms of the plan, options must be granted to all employees of any corporation whose employees are granted any options by reason of their employment by the corporation (see paragraph (e) of this section);

(v) Under the terms of the plan, all employees granted options must have the same rights and privileges (see paragraph (f) of this section);

(vi) Under the terms of the plan, the option price cannot be less than the lesser of—

(A) An amount equal to 85 percent of the fair market value of the stock at the time the option is granted, or

(B) An amount not less than 85 percent of the fair market value of the stock at the time the option is exercised (see paragraph (g) of this section);

(vii) Under the terms of the plan, options cannot be exercised after the expiration of—

(A) Five years from the date the option is granted if, under the terms of such plan, the option price cannot be less than 85 percent of the fair market value of the stock at the time the option is exercised, or

(B) Twenty-seven months from the date the option is granted, if the option price is not determined in the manner described in paragraph (A) (see paragraph (h) of this section);

(viii) Under the terms of the plan, no employee may be granted an option that permits the employee's rights to purchase stock under all employee stock purchase plans of the employer corporation and its related corporations to accrue at a rate that exceeds $25,000 of fair market value of the stock (determined at the time the option is granted) for each calendar year in which

the option is outstanding at any time (see paragraph (i) of this section); and

(ix) Under the terms of the plan, options are not transferable by the optionee other than by will or the laws of descent and distribution, and are exercisable, during the lifetime of the optionee, only by the optionee (see paragraph (j) of this section).

(3) The determination of whether a particular option is an option granted under an employee stock purchase plan is made at the time the option is granted. If the terms of an option are inconsistent with the terms of the employee stock purchase plan or an offering under the plan, the option will not be treated as granted under an employee stock purchase plan. If an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an employee who is entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under the offering that qualifies as an option granted under an employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421. However, if an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an individual who is not entitled to the grant of an option under the terms of the plan or offering, the option will not be treated as an option granted under an employee stock purchase plan, and the grant of the option will not disqualify the options granted under the plan or offering. If, at the time of grant, an option qualifies as an option granted under an employee stock purchase plan, but the terms of the option are not satisfied, the option will not be treated as granted under an employee stock purchase plan and this failure to comply with the terms of the option will not disqualify the options granted under the plan or offering.

(4) *Examples*. The following examples illustrate the principles of paragraph (a)(3):

Example 1. Corporation A operates an employee stock purchase plan under which options for A stock are granted to employees of A. The terms of an offering provide that the option price will be 90 percent of the fair market value of A stock on the date of exercise. A grants an option under the offering to Employee Z, an employee of A. The terms of the option provide that the option price will be 85 percent of the fair market value of A stock on the date of exercise. Because the terms of Z's option are inconsistent with the terms of the offering, the option granted to Z will not be treated as an option granted under the employee stock purchase plan. Further, unless Z is granted an option under the offering that qualifies as an option granted under the employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section and none of the options granted under the offering will be eligible for the special tax treatment of section 421.

Example 2. Corporation B operates an employee stock purchase plan that provides that options for B stock may only be granted to employees of B. Under the terms of the plan, options may not be granted to consultants and other non-employees. B grants an option under the plan to Consultant Y, a consultant of B. Because Y is ineligible to receive an option under the plan by reason of Y's status as a non-employee, the grant of the option to Y is inconsistent with the terms of the plan and the option granted to Y will not be treated as an option granted under the employee stock purchase plan. However, the grant of the option to Y will not disqualify the options granted under the plan or offering because Y was not entitled to the grant of an option under the plan.

Example 3. Corporation C operates an employee stock purchase plan under which options for C stock are granted to employees of C. C grants an option under the plan to Employee X, an employee of C who is a highly compensated employee. The terms of the employee stock purchase plan exclude highly compensated employees from participation in the plan. Because X is ineligible to receive an option under the plan by reason of X's exclusion from participation in the plan, the option granted to X will not be treated as an option granted under the employee stock purchase plan. However, the grant of the option to X will not disqualify the options granted under the plan or offering because X was not entitled to the grant of an option under the plan.

Example 4. Corporation D operates an employee stock purchase plan under which options for D stock are granted to employees of D. D grants an option under the plan to Employee W, an employee of D. The terms of the option provide that the option price will be 90 percent of the fair market value of D stock on the date of exercise. On the date of exercise, W pays only 85 percent of the fair market value of D stock. Because the terms of W's option are not satisfied, the option granted to W will not be treated as an option granted under the employee stock purchase plan. However, the failure to comply with the terms of the option granted to W will not disqualify the options granted under the plan or offering.

(b) *Options restricted to employees*. An employee stock purchase plan must provide that options can be granted only to employees of the employer corporation (or employees of its related corporations) to purchase stock in the employer corporation (or one of its related corporations). If such a provision is not included in the terms of the plan, the plan will not be an employee stock purchase plan and options granted under the plan will not qualify for the special tax treatment of section 421. For rules relating to the employment requirement, see paragraph (h) of §1.421–1.

(c) *Stockholder approval*—(1) An employee stock purchase plan must be approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted. The approval of the stockholders must comply with all applicable provisions of the corporate charter, bylaws and applicable State law prescribing the method and degree of stockholder approval required for the issuance of corporate stock or options. If the applicable State law does not prescribe a method and degree of stockholder approval, then an employee stock purchase plan must be approved—

(i) By a majority of the votes cast at a duly held stockholder's meeting at which a quorum representing a majority of all outstanding voting stock is, either in person or by proxy, present and voting on the plan; or

(ii) By a method and in a degree that would be treated as adequate under applicable State law in the case of an action requiring stockholder approval (such as, an action on which stockholders would be entitled to vote if the action were taken at a duly held stockholders' meeting).

(2) For purposes of the stockholder approval required by this paragraph (c), ordinarily, a plan is adopted when it is approved by the granting corporation's board of directors, and the date of the board's action is the reference point for determining whether stockholder approval occurs within the applicable 24-month period. However, if the board's action is subject to a condition (such as stockholder approval) or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of approval as the date of the board's action.

(3) An employee stock purchase plan, as adopted and approved, must designate the maximum aggregate number of shares that may be issued under the plan, and the corporations or class of corporations whose employees may be offered options under the plan. A plan that merely provides that the number of shares that may be issued under the plan may not exceed a stated percentage of the shares outstanding at the time of each offering or grant under the plan does not satisfy the requirements of this paragraph (c)(3). However, the maximum aggregate number of shares

that may be issued under the plan may be stated in terms of a percentage of the authorized, issued, or outstanding shares on the date of the adoption of the plan. The plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued, or outstanding shares on the date of the adoption of the plan. A plan that provides that the maximum aggregate number of shares that may be issued as options under the plan may change based on any other specific circumstances satisfies the requirements of this paragraph only if the stockholders approve an immediately determinable maximum number of shares that may be issued under the plan in any event. If there is more than one employee stock purchase plan under which options may be granted and stockholders of the granting corporation merely approve a maximum aggregate number of shares that are available for issuance under the plans, the stockholder approval requirements described in paragraph (c)(1) of this section are not satisfied. A separate maximum aggregate number of shares available for issuance pursuant to options must be specified and approved for each plan.

(4) Once an employee stock purchase plan is approved by the stockholders of the granting corporation, the plan need not be reapproved by the stockholders of the granting corporation within the prescribed 24-month period unless the plan is amended or changed in a manner that is considered the adoption of a new plan. Any increase in the aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in the number of outstanding shares, such as a stock dividend or stock split) will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. Similarly, a change in the designation of corporations whose employees may be offered options under the plan will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period unless the plan provides that designations of participating corporations may be made from time to time from among a group consisting of the granting corporation and its related corporations. The group from among which such changes and designations are permitted without additional stockholder approval may include corporations having become parents or subsidiaries of the granting corporation after the adoption and approval of the plan. In addition, a change in the granting corporation or the stock available for purchase under the plan will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. Any other changes in the terms of an employee stock purchase plan are not considered the adoption of a new plan and, thus, do not require stockholder approval.

(5) *Examples*. The following examples illustrate the principles of this paragraph (c):

Example 1—(i) Corporation E is a subsidiary of Corporation F, a publicly traded corporation. On January 1, 2010, E adopts an employee stock purchase plan under which options for E stock are granted to E employees.

(ii) To meet the requirements of paragraph (c)(1) of this section, the plan must be approved by the stockholders of E (in this case, F) within 12 months before or after January 1, 2010.

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that the plan was approved by the stockholders of E (in this case, F) on March 1, 2010. On January 1, 2012, E changes the plan to provide that options for F stock will be granted to E employees under the plan. Because there is a change in the stock available for grant under the plan, under paragraph (c)(4) of this section, the change is considered the adoption of a new plan that must be approved by the stockholders of E (in this case, F) within 12 months before or after January 1, 2012.

Example 2—(i) Assume the same facts as in paragraph (i) of *Example 1*, except that on March 15, 2011, F completely disposes of its interest in E. Thereafter, E continues to grant options for E stock to E employees under the plan.

(ii) The new E options are granted under a plan that meets the stockholder approval requirements of paragraph (c)(1) of this section without regard to whether E seeks approval of the plan from the stockholders of E after F disposes of its interest in E.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that under the plan as adopted on January 1, 2010, only options for F stock are granted to E employees. Assume further that, after F disposes of its interest in E, E changes the plan to provide for the grant of options for E stock to E employees. Because there is a change in the stock available for purchase or grant under the plan, under paragraph (c)(4) of this section, the stockholders of E must approve the plan within 12 months before or after the change to the plan to meet the stockholder approval requirements of paragraph (c) of this section.

Example 3—(i) Corporation G maintains an employee stock purchase plan. Corporation H does not maintain an employee stock purchase plan. On May 15, 2010, G and H consolidate under State law to form one corporation. The new corporation is named Corporation H. The consolidation agreement describes the G plan, including the maximum aggregate number of shares available for issuance under the plan after the consolidation. Additionally, the consolidation agreement states that the plan will be continued by H after the consolidation. The consolidation agreement is unanimously approved by the stockholders of G and H on May 1, 2010. H assumes the plan formerly maintained by G and continues to grant options under the plan to all eligible employees.

(ii) Because there is a change in the granting corporation (from G to H), under paragraph (c)(4) of this section, H is considered to have adopted a new plan. Because the plan is fully described in the consolidation agreement, including the maximum aggregate number of shares available for issuance under the plan, the approval of the consolidation agreement by the stockholders constitutes approval of the plan. Thus, the stockholder approval of the consolidation agreement satisfies the stockholder approval requirements of paragraph (c)(1) of this section, and the plan is considered to be adopted by H and approved by its stockholders on May 1, 2010.

Example 4. Corporation I adopts an employee stock purchase plan on November 1, 2010. On that date, there are two million shares of I stock outstanding. The plan provides that the maximum aggregate number of shares that may be issued under the plan may not exceed 15 percent of the number of shares of I stock outstanding on November 1, 2010. Because the maximum aggregate number of shares that may be issued under the plan is designated in the plan, the requirements of paragraph (c)(3) of this section are met.

Example 5—(i) Corporation J adopts an employee stock purchase plan on March 15, 2010. The plan provides that the maximum aggregate number of shares of J stock available for issuance under the plan is 50,000, increased on each anniversary date of the adoption of the plan by 5 percent of the then outstanding shares. Because the maximum aggregate number of shares is not designated under the plan, the requirements of paragraph (c)(3) of this section are not met.

(ii) Assume the same facts as in paragraph (i) of this *Example 5*, except that the plan provides that the maximum aggregate number of shares available under the plan is the lesser of (a) 50,000 shares, increased each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares, or (b) 200,000 shares. Because the maximum aggregate number of shares that may be issued under the plan is designated as the lesser of two numbers, one of which provides an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event, the requirements of paragraph (c)(3) of this section are met.

(d) *Options granted to certain shareholders*—(1) An employee stock purchase plan must by its terms provide that an employee cannot be granted an option if the employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or a related corporation. In determining whether the stock ownership of an employee equals or ex-

ceeds this 5 percent limit, the rules of section 424(d) (relating to attribution of stock ownership) shall apply, and stock that the employee may purchase under outstanding options (whether or not the options qualify for the special tax treatment afforded by section 421(a)) shall be treated as stock owned by the employee. An option is outstanding for purposes of this paragraph (d) although under its terms it may be exercised only in installments or after the expiration of a fixed period of time. If an option is granted to an employee whose stock ownership (as determined under this paragraph (d)) exceeds the limitation set forth in this paragraph (d), no portion of the option will be treated as having been granted under an employee stock purchase plan.

(2) The determination of the percentage of the total combined voting power or value of all classes of stock of the employer corporation (or a related corporation) that is owned by the employee is made by comparing the voting power or value of the shares owned (or treated as owned) by the employee to the aggregate voting power or value of all shares actually issued and outstanding immediately after the grant of the option to the employee. The aggregate voting power or value of all shares actually issued and outstanding immediately after the grant of the option does not include the voting power or value of treasury shares or shares authorized for issue under outstanding options held by the employee or any other person.

(3) *Examples*. The following examples illustrate the principles this paragraph (d):

Example 1. Employee V, an employee of Corporation K, owns 6,000 shares of K common stock, the only class of K stock outstanding. K has 100,000 shares of its common stock outstanding. Because V owns 6 percent of the combined voting power or value of all classes of K stock, K cannot grant an option to V under K's employee stock purchase plan. If V's father and brother each owned 3,000 shares of K stock and V did not own any K stock, then the result would be the same because, under section 424(d), an individual is treated as owning stock held by the person's father and brother. Similarly, the result would be the same if, instead of actually owning 6,000 shares, V merely held an option on 6,000 shares of K stock, irrespective of whether the transfer of stock under the option could qualify for the special tax treatment of section 421, because this paragraph (d) provides that stock the employee may purchase under outstanding options is treated as stock owned by such employee.

Example 2. Assume the same facts as in *Example 1*, except that K is a subsidiary corporation of Corporation L. Irrespective of whether V owns any L stock, V cannot receive an option from L under L's employee stock purchase plan because he owns 5 percent of the total combined voting power of all classes of stock of a subsidiary of L, in this example, K. An employee who owns (or is treated as owning) stock in excess of the limitation of this paragraph (d), in any corporation in a group of related corporations, consisting of a parent and its subsidiary corporations, cannot receive an option under an employee stock purchase plan from any corporation in the group.

Example 3. Employee U is an employee of Corporation M. M has only one class of stock, of which 100,000 shares are issued and outstanding. Assuming U does not own (and is not treated as owning) any stock in M or in any related corporation of M, M may grant an option to U under its employee stock purchase plan for 4,999 shares, because immediately after the grant of the option, U would not own 5 percent or more of the combined voting power or value of all classes of M stock actually issued and outstanding at such time. The 4,999 shares that U would be treated as owning under this paragraph (d) would not be added to the 100,000 shares actually issued and outstanding immediately after the grant for purposes of determining whether U's stock ownership exceeds the limitation of this paragraph (d).

Example 4. Assume the same facts as in *Example 3* but instead of an option for 4,999 shares, M grants U an option, purportedly under its employee stock purchase plan, for 5,000 shares. No portion of this option will be treated as granted under an employee stock purchase plan because U's stock ownership exceeds the limitation of this paragraph (d).

(e) *Employees covered by plan*—(1) Subject to the provisions of this paragraph (e) and the limitations of paragraphs (d), (f) and (i) of this section, an employee stock purchase plan must, by its terms, provide that options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by the corporation, except that one or more of the following categories of employees may be excluded from the coverage of the plan—

(i) Employees who have been employed less than two years;

(ii) Employees whose customary employment is 20 hours or less per week;

(iii) Employees whose customary employment is for not more than five months in any calendar year; and

(iv) Highly compensated employees (within the meaning of section 414(q)).

(2) An employee stock purchase plan does not fail to satisfy the coverage provision of paragraph (e)(1) of this section in the following circumstances—

(i) The plan excludes employees who have completed a shorter period of service or whose customary employment is for fewer hours per week or fewer months in a calendar year than is specified in paragraph (e)(1)(i), (ii) and (iii), provided the exclusion is applied in an identical manner to all employees of every corporation whose employees are granted options under the plan.

(ii) The plan excludes highly compensated employees (within the meaning of section 414(q)) with compensation above a certain level or who are officers or subject to the disclosure requirements of section 16(a) of the Securities Exchange Act of 1934, provided the exclusion is applied in an identical manner to all highly compensated employees of every corporation whose employees are granted options under the plan.

(3) Notwithstanding paragraph (e)(1) of this section, employees who are citizens or residents of a foreign jurisdiction (without regard to whether they are also citizens of the United States or resident aliens (within the meaning of section 7701(b)(1)(A))) may be excluded from the coverage of an employee stock purchase plan under the following circumstances—

(i) The grant of an option under the plan to a citizen or resident of the foreign jurisdiction is prohibited under the laws of such jurisdiction; or

(ii) Compliance with the laws of the foreign jurisdiction would cause the plan to violate the requirements of section 423.

(4) No option granted under a plan or offering that excludes from participation any employees, other than those who may be excluded under this paragraph (e), and those barred from participation by reason of paragraphs (d), (f) and (i) of this section, can be regarded as having been granted under an employee stock purchase plan. If an option is not granted to any employee who is entitled to the grant of an option under the terms of the plan or offering, none of the options granted under such offering will be treated as having been granted under an employee stock purchase plan. However, a plan that, by its terms, permits all eligible employees to elect to participate in an offering will not violate the requirements of this paragraph solely because eligible employees who elect not to participate in the offering are not granted options pursuant to such offering.

(5) For purposes of this paragraph (e), the existence of the employment relationship between an individual and the corporation participating under the plan will be determined under paragraph (h) of §1.421–1.

(6) *Examples*. The following examples illustrate the principles of this paragraph (e):

Example 1. Corporation N has a stock purchase plan that meets all the requirements of paragraph (a)(2) of this section except that options are not required to be granted to employees whose weekly rate of pay is less than $1,000. As a matter of corporate practice, however, N grants options under its plan to all employees, irrespective of their weekly rate of pay. Even though N's plan is operated in compliance with the requirements of this paragraph (e), N's plan is not an employee stock purchase plan because the terms of the plan exclude a category of employees that is not permitted under this paragraph (e).

Example 2. Assume the same facts as in *Example 1*, except that the first offering under N's plan provides that options will be granted to all employees of N. The terms of the first offering will be treated as part of the terms of N's plan, but only for purposes of the first offering. Because the terms of the first offering satisfy the requirements of this paragraph (e), stock transferred pursuant to options exercised under the first offering will be treated as stock transferred pursuant to the exercise of options granted under an employee stock purchase plan for purposes of section 421.

Example 3. Corporation O has a stock purchase plan that excludes from participation all employees who have been employed less than one year. Assuming all other requirements of paragraph (a)(2) of this section are satisfied, O's plan qualifies as an employee stock purchase plan under section 423.

Example 4. Corporation P has a stock purchase plan that excludes from participation clerical employees who have been employed less than two years. However, non-clerical employees with less than two years of service are permitted to participate in the plan. P's plan is not an employee stock purchase plan because the exclusion of employees who have been employed less than two years applies only to certain employees of P and is not applied in an identical manner to all employees of P. If, instead, P's plan excludes from participation all employees (both clerical and non-clerical) who have been employed less than two years, then P's plan would qualify as an employee stock purchase plan under section 423 assuming all other requirements of paragraph (a)(2) of this section are satisfied.

Example 5. Corporation Q has a stock purchase plan that excludes from participation all officers who are highly compensated employees (within the meaning of section 414(q)). Assuming all other requirements of paragraph (a)(2) of this section are satisfied, Q's plan qualifies as an employee stock purchase plan under section 423.

Example 6. Corporation R maintains an employee stock purchase plan that excludes from participation all highly compensated employees (within the meaning of section 414(q)), except highly compensated employees who are officers of R. R's plan is not an employee stock purchase plan because the exclusion of all highly compensated employees except highly compensated employees who are officers of R is not a permissible exclusion under paragraph (e)(2)(ii) of this section.

Example 7. Corporation S is the parent corporation of Subsidiary YY and Subsidiary ZZ. S maintains an employee stock purchase plan with both YY and ZZ participating under the plan. Under the terms of the plan, all employees of YY and ZZ are permitted to participate in the plan with the exception of ZZ's highly compensated employees with annual compensation greater than $300,000. S's plan is not an employee stock purchase plan because the exclusion of highly compensated employees with annual compensation greater than $300,000 is not applied in an identical manner to all employees of YY and ZZ.

Example 8. The laws of Country A require that options granted to residents of Country A be transferable during the lifetime of the option recipient. Corporation T has a stock purchase plan that excludes residents of Country A from participation in the plan. Because compliance with the laws of Country A would cause options granted to residents of Country A to violate paragraph (j) of this section, T may exclude residents of Country A from participation in the plan. Assuming all other requirements of paragraph (a)(2) of this section are satisfied, T's plan qualifies as an employee stock purchase plan under section 423.

(f) *Equal rights and privileges*—(1) Except as otherwise provided in paragraphs (f)(2) through (f)(6) of this section, an employee stock purchase plan must, by its terms, provide that all employees granted options under the plan shall have the same rights and privileges. Thus, the provisions applying to one option under an offering (such as the provisions relating to the method of payment for the stock and the determination of the purchase price per share) must apply to all other options under the offering in the same manner. If all the options granted under a plan or offering do not, by their terms, give the respective optionees the same rights and privileges, none of the options will be treated as having been granted under an employee stock purchase plan for purposes of section 421.

(2) The requirements of this paragraph (f) do not prevent the maximum amount of stock that an employee may purchase from being determined on the basis of a uniform relationship to the total compensation, or the basic or regular rate of compensation, of all employees.

(3) A plan or offering will not fail to satisfy the requirements of this paragraph (f) because the plan or offering provides that no employee may purchase more than a maximum amount of stock fixed under the plan.

(4) A plan or offering will not fail to satisfy the requirements of this paragraph (f) if, in order to comply with the laws of a foreign jurisdiction, the terms of an option granted under a plan or offering to citizens or residents of such foreign jurisdiction (without regard to whether they are also citizens of the United States or resident aliens (within the meaning of section 7701(b)(1)(A))) are less favorable than the terms of options granted under the same plan or offering to employees resident in the United States.

(5)(i) Except as provided in this paragraph and paragraph (f)(5)(ii) of this section, a plan permitting one or more employees to carry forward amounts that were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply the amounts towards the purchase of additional stock under a subsequent plan or offering will be a violation of the equal rights and privileges under paragraph (f)(1) of this section. However, the carry forward of amounts withheld but not applied toward the purchase of stock under an earlier plan or offering will not violate the equal rights and privileges requirement of paragraph (f)(1) of this section if all other employees participating in the current plan or offering are permitted to make direct payments toward the purchase of shares under a subsequent plan or offering in an amount equal to the excess of the greatest amount which any employee is allowed to carry forward from an earlier plan or offering over the amount, if any, the employee will carry forward from an earlier plan or offering.

(ii) A plan will not fail to satisfy the requirements of this section merely because employees are permitted to carry forward amounts representing a fractional share, that were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply the amounts toward the purchase of additional stock under a subsequent plan or offering.

(6) Paragraph (f) does not prohibit the delaying of the grant of an option to any employee who is barred from being granted an option solely by reason of the employee's failing to meet a minimum service requirement set forth in paragraph (e)(1) of this section until the employee meets such requirement.

(7) *Examples*. The following examples illustrate the principles of this paragraph (f):

Example 1. Corporation U has an employee stock purchase plan that provides that the maximum amount of stock that each employee may purchase under the offering is one share for each $100 of annual gross pay. The plan meets the requirements of this paragraph (f).

Example 2. Corporation V has an employee stock purchase plan that provides that the maximum amount of stock that each employee may purchase under the offering is one share for each $100 of annual gross pay up to and including $10,000, and two shares for each $100 of annual gross pay in excess of $10,000. The plan will not meet the requirements of this paragraph (f) because the amount of stock that may be purchased under the plan is not based on a uniform relationship to the total compensation of all employees.

Example 3. Corporation W has an employee stock purchase plan that provides that options to purchase stock in an amount equal to ten percent of an employee's annual salary at a price equal to 85 percent of the fair market value on the first day of the offering will be granted to all employees other than those who have been employed less than 18 months. In addition, the plan provides that employees who have not yet met the minimum service requirements on the first day of the offering will be granted similar options on the date the 18 month service requirement has been attained. The plan meets the requirements of this paragraph (f).

Example 4. Corporation X has an employee stock purchase plan that provides that options to purchase stock at a price equal to 90 percent of the fair market value at the time the option is exercised will be granted to all employees. The laws of Country B provide that options granted to employees who are residents of Country B must have a purchase price not less than 95 percent of the fair market value at the time the option is exercised. The plan will not fail to satisfy the requirements of this paragraph (f) merely because the residents of Country B are granted options under the plan to purchase stock at a price equal to 95 percent of the fair market value at the time the option is exercised.

Example 5. Corporation Y maintains an employee stock purchase plan. Employee T is employed by Y. T is granted an option under the current offering to purchase a maximum of 100 shares of Y stock at an option price equal to 85 percent of the fair market value of the stock at exercise. The plan permits the carry forward of withheld but unused amounts from an earlier offering. Prior to the exercise date, $2000 of T's salary has been withheld and is available to be applied toward the purchase of Y stock. On the exercise date, the fair market value of Y stock is $20 per share. T is able to purchase 100 shares of Y stock at $17 per share for an aggregate purchase price of $1700. T can carry forward $300 to the subsequent offering. Each employee in the subsequent offering other than T will be permitted to make direct payments toward the purchase of shares under the subsequent offering in a maximum amount of $300 less any amount the employee has carried forward from an earlier offering. The plan does not violate the equal rights and privileges requirement of this paragraph (f).

(g) *Option price*—(1) An employee stock purchase plan must, by its terms, provide that the option price will not be less than the lesser of—

(i) An amount equal to 85 percent of the fair market value of the stock at the time the option is granted, or

(ii) An amount that under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time the option is exercised.

(2) The option price may be determined in any reasonable manner, including the valuation methods permitted under §20.2031–2, so long as the option price meets the minimum pricing requirements of this paragraph (g). For general rules relating to the option price, see paragraph (e) of §1.421–1. For rules relating to the determination of when an option is granted, see paragraph (c) of §1.421–1 and §1.423–2(h)(2). Any option that does not meet the minimum pricing requirements of this paragraph (g) will not be treated as an option granted under an employee stock purchase plan irrespective of whether the plan or offering satisfies those requirements. If an option that does not meet the minimum pricing requirements is granted to an employee who is entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under such offering that qualifies as an option granted under an employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421.

(3) The option price may be stated either as a percentage or as a dollar amount. If the option price is stated as a dollar amount, then the requirement of this paragraph (g) can only be met by a plan or offering in which the price is fixed at not less than 85 percent of the fair market value of the stock at the time the option is granted. If the fixed price is less than 85 percent of the fair market value of the stock at grant, then the option cannot meet the requirement of this paragraph (g) even if a decline in the fair market value of the stock results in such fixed price being not less than 85 percent of the fair market value of the stock at the time the option is exercised, because that result was not certain to occur under the terms of the option.

(4) *Examples*. The following examples illustrate the principles of this paragraph (g):

Example 1. Corporation Z has an employee stock purchase plan that provides that the option price will be 85 percent of the fair market value of the stock on the first day of the offering (which is the date of grant in this case), or 85 percent of the fair market value of the stock at exercise, whichever amount is the lesser. Upon the exercise of an option issued under Z's plan, Z agrees to accept an option price that is less than the minimum amount allowable under the terms of such plan. Notwithstanding that the option was issued under an employee stock purchase plan, the transfer of stock pursuant to the exercise of such option does not satisfy the requirement of this paragraph (g) and cannot qualify for the special tax treatment of section 421.

Example 2. Corporation AA has an employee stock purchase plan that provides that the option price is set at 85 percent of the fair market value of AA stock at exercise, but not less than $80 per share. On the first day of the offering (which is the date of grant in this case), the fair market value of AA stock is $100 per share. The option satisfies the requirement of this paragraph (g), and can qualify for the special tax treatment of section 421.

Example 3. Assume the same facts as in *Example 2*, except that the option price is set at 85 percent of the fair market value of AA stock at exercise, but not more than $80 per share. This option cannot satisfy the requirement of this paragraph (g) irrespective of whether, at the time the option is exercised, 85 percent of the fair market value of AA stock is $80 or less.

(h) *Option period*—(1) An employee stock purchase plan must, by its terms, provide that options granted under the plan cannot be exercised after the expiration of 27 months from the date of grant unless, under the terms of the plan, the option price is not less than 85 percent of the fair market value of the stock at the time of the exercise of the option. If the option price is not less than 85 percent of the fair market value of the stock at the time the option is exercised, then the option period provided under the plan must not exceed five years from the date of grant. If the requirements of this paragraph (h) are not met by the terms of the plan or offering, then options issued under such plan or offering will not be treated as options granted under an employee stock purchase plan irrespective of whether the options, by their terms, are exercisable beyond the period allowable under this paragraph (h). An option that provides that the option price is not less than 85 percent of the fair market value of the stock at exercise may have an option period of 5 years irrespective of whether the fair market value of the stock at exercise is more or less than the fair market value of the stock at grant. However, if the option provides that the option price is 85 percent of the fair market value of the stock at exercise, but not more than some other fixed amount determined in accordance with the provisions of paragraph (g) of this section,

then irrespective of the price paid on exercise, the option period must not be more than 27 months.

(2) Section 1.421–1(c) provides that, for purposes of §§1.421–1 through 1.424–1, the language *the date of the granting of the option* and *the time such option is granted*, and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. With respect to options granted under an employee stock purchase plan, the principles of §1.421–1(c) shall be applied without regard to the requirement that the minimum option price must be fixed or determinable in order for the corporate action constituting an offer of stock to be considered complete.

(3) The date of grant will be the first day of an offering if the terms of an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering. Similarly, the date of grant will be the first day of an offering if the terms of the plan or offering require the application of a formula to establish, on the first day of the offering, the maximum number of shares that may be purchased by each employee during the offering. It is not required that an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering or incorporate a formula to establish a maximum number of shares that may be purchased by each employee during the offering. If the maximum number of shares that can be purchased under an option is not fixed or determinable until the date the option is exercised, then the date of exercise will be the date of grant of the option.

(4) *Examples*. The following examples illustrate the principles of this paragraph (h):

Example 1—(i) Corporation BB has an employee stock purchase plan that provides that the option price will be the lesser of 85 percent of the fair market value of the stock on the first day of an offering or 85 percent of the fair market value of the stock on the last day of the offering. Options are exercised on the last day of the offering. One million shares of BB stock are reserved for issuance under the plan. The plan provides that no employee may be permitted to purchase stock under the plan at a rate that exceeds $25,000 in fair market value of the BB stock (determined on the date of grant) for each calendar year during which an option granted to the employee is outstanding and exercisable. The terms of each option granted under an offering provide that a maximum of 500 shares may be purchased by the option recipient during the offering. Because the maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering, the date of grant for the option is the first day of the offering.

(ii) Assume the same facts as in paragraph (i) of *Example 1* except that BB's plan excludes all employees who have been employed less than 18 months. The plan provides that employees who have not yet met the minimum service requirements on the first day of an offering will be granted an option on the date the 18-month service requirement has been attained. With respect to those employees who have been employed less than 18 months on the first day of an offering, the date of grant for the option is the date the 18-month service requirement has been attained.

Example 2. Assume the same facts as in paragraph (i) of *Example 1* except that the terms of each option granted do not provide that a maximum of 500 shares may be purchased by the option recipient during the offering. Notwithstanding the fixed number of shares reserved for issuance under the plan and the $25,000 limitation set forth in the plan, the maximum number of shares that can be purchased under the option is not fixed or determinable until the last day of the offering when the option is exercised. Therefore the date of grant for the option is the last day of the offering when the option is exercised.

Example 3. Corporation CC has an employee stock purchase plan that provides that the option price will be 85 percent of the fair market value of the stock on the last day of the offering. Options are exercised on the last day of the offering. Each offering under the plan begins on January 1 and ends on December 31 of the same calendar year. The terms of each option granted under an offering provide that the maximum number of shares that may be purchased by any employee during the offering equals $25,000 divided by the fair market value of the stock on the first day of the offering. The maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering and therefore the date of grant for the option is the first day of the offering.

Example 4. Assume the same facts as in *Example 3* except that the terms of each option granted under an offering provide that the maximum number of shares that may be purchased by any employee during the offering equals 10 percent of the employee's annual salary (determined as of January 1 of the year in which the offering commences) divided by the fair market value of the stock on the first day of the offering. The maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering and therefore the date of grant for the option is the first day of the offering.

(i) *Annual $25,000 limitation*—(1) An employee stock purchase plan must, by its terms, provide that no employee may be permitted to purchase stock under all the employee stock purchase plans of the employer corporation and its related corporations at a rate that exceeds $25,000 in fair market value of the stock (determined at the time the option is granted) for each calendar year in which any option granted to the employee is outstanding at any time. In applying the foregoing limitation—

(i) The right to purchase stock under an option is deemed to accrue when the option (or any portion thereof) first becomes exercisable during the calendar year;

(ii) The right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

(iii) A right to purchase stock that has accrued under one option granted pursuant to the plan may not be carried over to any other option.

(2) If an option is granted under an employee stock purchase plan that satisfies the requirement of this paragraph (i), but the option gives the optionee the right to buy stock in excess of the maximum rate allowable under this paragraph (i), then no portion of the option will be treated as having been granted under an employee stock purchase plan. Furthermore, if the option was granted to an employee entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under the offering that qualifies as an option granted under an employee stock purchase plan, then the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421.

(3) The limitation of this paragraph (i) applies only to options granted under employee stock purchase plans and does not limit the amount of stock that an employee may purchase under incentive stock options (as defined in section 422(b)) or any other stock options except those to which section 423 applies. Stock purchased under options to which section 423 does not apply will not limit the amount that an employee may purchase under an employee stock purchase plan, except for purposes of the 5-percent stock ownership provision of paragraph (d) of this section.

(4) Under the limitation of this paragraph (i), an employee may purchase up to $25,000 of stock (based on the fair market value of the stock at the time the option was granted) in each calendar year

during which an option granted to the employee under an employee stock purchase plan is outstanding and exercisable. Alternatively, an employee may purchase more than $25,000 of stock (based on the fair market value of such stock at the time the option was granted) in a calendar year, so long as the total amount of stock that the employee purchases does not exceed $25,000 in fair market value of the stock (determined at the time the option was granted) for each calendar year in which the option was outstanding and exercisable. If, in any calendar year, the employee holds two or more outstanding and exercisable options granted under employee stock purchase plans of the employer corporation, or a related corporation, then the employee's purchases of stock attributable to that year under all options granted under employee stock purchase plans must not exceed $25,000 in fair market value of the stock (determined at the time the options were granted). Under an employee stock purchase plan, an employee may not purchase stock in anticipation that the option will be outstanding and exercisable in some future year. Thus, the employee may purchase only the amount of stock that does not exceed the limitation of this paragraph (i) for the year of the purchase and for preceding years during which the option was outstanding and exercisable. Thus, the amount of stock that may be purchased under an option depends on the number of years in which the option is actually outstanding and exercisable. The amount of stock that may be purchased under an employee stock purchase plan may not be increased by reason of the failure to grant an option in an earlier year under such plan, or by reason of the failure to exercise an earlier option. For example, if an option is granted to an individual and expires without having been exercised at all, then the failure to exercise the option does not increase the amount of stock which such individual may be permitted to purchase under an option granted in a year following the year of such expiration. If an option granted under an employee stock purchase plan is outstanding and exercisable in more than one calendar year, then stock purchased pursuant to the exercise of such an option will be applied first, to the extent allowable under this paragraph (i), against the $25,000 limitation for the earliest year in which the option was outstanding and exercisable, then, against the $25,000 limitation for each succeeding year, in order.

(5) *Examples*. The following examples illustrate the principles of this paragraph (i):

Example 1. Assume that Corporation DD maintains an employee stock purchase plan and that Employee S is employed by DD. On June 1, 2010, DD grants S an option under the plan to purchase a total of 750 shares of DD stock at $85 per share. On that date, the fair market value of DD stock is $100 per share. The option provides that it may be exercised at any time but cannot be exercised after May 31, 2012. Under this paragraph (i), the option must not permit S to purchase more than 250 shares of DD stock during the calendar year 2010, because 250 shares are equal to $25,000 in fair market value of DD stock determined at the time of grant. During the calendar year 2011, S may purchase under the option an amount of DD stock equal to the difference between $50,000 in fair market value of DD stock (determined at the time the option was granted) and the fair market value of DD stock (determined at the time of grant of the option) purchased during the year 2010. During the calendar year 2012, S may purchase an amount of DD stock equal to the difference between $75,000 in fair market value of the stock (determined at the time of grant of the option) and the total amount of the fair market value of the stock (determined at the time of grant of the option) purchased under the option during the calendar years 2010 and 2011. S may purchase $25,000 of stock for the year 2010, and $25,000 of stock for the year 2012, although the option was outstanding and exercisable for only a part of each of such years. However, S may not be granted another option under an employee stock purchase plan of DD or a related corporation to purchase stock of DD or a related corporation during the calendar years 2010, 2011, and 2012, so long as the option granted June 1, 2010, is outstanding.

Example 2. Assume the same facts as in *Example 1*, except that the option granted to S in 2010 is terminated in 2011 without any part of the option having been exercised, and that subsequent to the termination and during 2011, S is granted another option under DD's employee stock purchase plan. Under that option, S may be permitted to purchase $25,000 of stock for 2011. The failure of S to exercise the option granted to S in 2010, does not increase the amount of stock that S may be permitted to purchase under the option granted to S in 2011.

Example 3. Assume the same facts as in *Example 1*, except that, on May 31, 2012, S exercised the option granted to S in 2010, and purchased 600 shares of DD stock. Five hundred shares, the maximum amount of stock that could have been purchased in 2011, under the option, are treated as having been purchased for the years 2010 and 2011. Only 100 shares of the stock are treated as having been purchased for 2012. After S's exercise of the option on May 31, 2012, S is granted another option under DD's employee stock purchase plan. S may be permitted under the new option to purchase for 2012 stock having a fair market value of no more than $15,000 at the time the new option is granted.

Example 4. Corporation EE maintains an employee stock purchase plan and Employee R is employed by EE. On August 1, 2010, EE grants R an option under the plan to purchase 150 shares of EE stock at $85 per share during each of the calendar years 2010, 2011, and 2012. On that date, the fair market value of EE stock is $100 per share. The option provides that it may be exercised at any time during years 2010, 2011, and 2012. Because this option permits R to purchase only $15,000 of EE's stock for each year the option is outstanding and exercisable, R could be granted another option by EE, or by a related corporation, in year 2010, permitting R to purchase an additional $10,000 of stock during each of the calendar years 2010, 2011, and 2012.

Example 5. Corporation FF maintains an employee stock purchase plan and Employee Q is employed by FF. On September 1, 2010, FF grants Q an option under the plan that will be automatically exercised on August 31, 2011, and August 31, 2012. On August 31, 2011, Q may purchase under the option an amount of FF stock equal to $25,000 in fair market value of FF stock (determined at the time the option was granted). On August 31, 2012, Q may purchase under the option an amount of FF stock equal to the difference between $50,000 in fair market value of Q stock (determined at the time the option was granted) and the fair market value of Q stock (determined at the time of grant of the option) purchased during year 2011.

(j) *Restriction on transferability*. An employee stock purchase plan must, by its terms, provide that options granted under the plan are not transferable by the optionee other than by will or the laws of descent and distribution, and must be exercisable, during the optionee's lifetime, only by the optionee. For general rules relating to the restriction on transferability required by this paragraph (j), see paragraph (b)(2) of §1.421–1. For a limited exception to the requirement of this paragraph (j), see section 424(h)(3).

(k) *Special rule where option price is between 85 percent and 100 percent of value of stock*—(1)(i) If all the conditions necessary for the application of section 421(a) exist, this paragraph (k) provides additional rules that are applicable in cases where, at the time the option is granted, the option price per share is less than 100 percent (but not less than 85 percent) of the fair market value of the share. In that case, upon the disposition of the share by the employee after the expiration of the two-year and the one-year holding periods, or upon the employee's death while owning the share (whether occurring before or after the expiration of such periods), there shall be included in the employee's gross income as compensation (and not as gain upon the sale or exchange of a capital asset) the lesser of—

(A) The amount, if any, by which the price paid under the option was exceeded by the fair market value of the share at the time the option was granted, or

(B) The amount, if any, by which the price paid under the option was exceeded by the fair market value of the share at the time of such disposition or death.

(ii) For purposes of applying the rules of this paragraph (k), if the option price is not fixed or determinable at the time the option is granted, the option price will be computed as if the option had been exercised at such time. The amount of compensation resulting from the application of this paragraph (k) shall be included in the employee's gross income for the taxable year in which the disposition occurs, or for the taxable year closing with the employee's death, whichever event results in the application of this paragraph (k).

(iii) The application of the special rules provided in this paragraph (k) shall not affect the rules provided in section 421(a) with respect to the employee exercising the option, the employer corporation, or a related corporation. Thus, notwithstanding the inclusion of an amount as compensation in the gross income of an employee, as provided in this paragraph (k), no income results to the employee at the time the stock is transferred to the employee, and no deduction under section 162 is allowable at any time to the employer corporation or a related corporation with respect to such amount.

(iv) If, during the employee's lifetime, the employee exercises an option granted under an employee stock purchase plan, but the employee dies before the stock is transferred to the employee pursuant to the exercise of the option, then the transfer of the stock to the employee's executor, administrator, heir, or legatee is deemed, for the purpose of sections 421 and 423, to be a transfer of the stock to the employee exercising the option and a further transfer by reason of death from the employee to the employee's executor, administrator, heir, or legatee.

(2) If the special rules provided in this paragraph (k) are applicable to the disposition of a share of stock by an employee, then the basis of the share in the employee's hands at the time of the disposition, determined under section 1011, shall be increased by an amount equal to the amount includible as compensation in the employee's gross income under this paragraph (k). However, the basis of a share of stock acquired after the death of an employee by the exercise of an option granted to the employee under an employee stock purchase plan shall be determined in accordance with the rules of section 421(c) and paragraph (c) of §1.421–2. If the special rules provided in this paragraph (k) are applicable to a share of stock upon the death of an employee, then the basis of the share in the hands of the estate or the person receiving the stock by bequest or inheritance shall be determined under section 1014, and shall not be increased by reason of the inclusion upon the decedent's death of any amount in the decedent's gross income under this paragraph (k). See *Example (9)* of this paragraph with respect to the determination of basis of the share in the hands of a surviving joint owner.

(3) *Examples*. The following examples illustrate the principles of this paragraph (k):

Example 1. On June 1, 2010, the Corporation GG grants to Employee P, an employee of GG, an option under GG's employee stock purchase plan to purchase a share of GG stock for $85. The fair market value of GG stock on such date is $100 per share. On June 1, 2011, P exercises the option and on that date GG transfers the share of stock to P. On January 1, 2013, P sells the share for $150, its fair market value on that date. P's income tax return is filed on the basis of the calendar year. The income tax consequences to P and GG are as follows—

(i) Compensation in the amount of $15 is includible in P's gross income for the year 2013, the year of the disposition of the share. The $15 represents the difference between the option price ($85) and the fair market value of the share on the date the option was granted ($100), because the value is less than the fair market value of the share on the date of disposition ($150). For the purpose of computing P's gain or loss on the sale of the share, P's cost basis of $85 is increased by $15, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100. Because the share was sold for $150, P realizes a gain of $50, which is treated as long-term capital gain; and

(ii) GG is not entitled to any deduction under section 162 at any time with respect to the share transferred to P.

Example 2. Assume the same facts as in *Example 1*, except that P sells the share of GG stock on January 1, 2014, for $75, its fair market value on that date. Because $75 is less than the option price ($85), no amount in respect of the sale is includible as compensation in P's gross income for the year 2014. P's basis for determining gain or loss on the sale is $85. Because P sold the share for $75, P realized a loss of $10 on the sale that is treated as a long-term capital loss.

Example 3. Assume the same facts as in *Example 1*, except that the option provides that the option price shall be 90 percent of the fair market value of the stock on the day the option is exercised. On June 1, 2011, when the option is exercised, the fair market value of the stock is $120 per share so that P pays $108 for the share of the stock. Compensation in the amount of $10 is includible in P's gross income for the year 2013, the year of the disposition of the share. This is determined in the following manner: the excess of the fair market value of the stock at the time of the disposition ($150) over the price paid for the share ($108) is $42; and the excess of the fair market value of the stock at the time the option was granted ($100) over the option price, computed as if the option had been exercised at such time ($90), is $10. Accordingly, $10, the lesser, is includible in gross income. In this situation, P's cost basis of $108 is increased by $10, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $118. Because the share was sold for $150, P realizes a gain of $32 that is treated as long-term capital gain.

Example 4. Assume the same facts as in *Example 1*, except that the option provides that the option price shall be the lesser of 95 percent of the fair market value of the stock on the first day of the offering period and 95 percent of the fair market value of the stock on the day the option is exercised. On June 1, 2011, when the option is exercised, the fair market value of the stock is $120 per share. P pays $95 for the share of the stock. Compensation in the amount of $5 is includible in P's gross income for the year 2013, the year of the disposition of the share. This is determined in the following manner: the excess of the fair market value of the stock at the time of the disposition ($150) over the price paid for the share ($95) is $55; and the excess of the fair market value of the stock at the time the option was granted ($100) over the option price, computed as if the option had been exercised at such time ($95), is $5. Accordingly, $5, the lesser, is includible in gross income. In this situation, P's cost basis of $95 is increased by $5, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100. Because the share was sold for $150, P realizes a gain of $50 that is treated as long-term capital gain.

Example 5. Assume the same facts as in *Example 1*, except that instead of selling the share on January 1, 2013, P makes a gift of the share on that day. In that case $15 is includible as compensation in P's gross income for 2013. P's cost basis of $85 is increased by $15, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100, which becomes the donee's basis, as of the time of the gift, for determining gain or loss.

Example 6. Assume the same facts as in *Example 2*, except that instead of selling the share on January 1, 2014, P makes a gift of the share on that date. Because the fair market value of the share on that day ($75) is less than the option price ($85), no amount in respect of the disposition by way of gift is includible as compensation in P's gross income for 2014. P's basis for the share is $85, which becomes the donee's basis, as of the time of the gift, for the purpose of determining gain. The donee's basis for the purpose of determining loss, determined under section 1015(a), is $75 (fair market value of the share at the date of gift).

Example 7. Assume the same facts as in *Example 1*, except that after acquiring the share of stock on June 1, 2011, P dies on August 1, 2012, at which time the share has a fair market value of $150. Compensation in the amount of $15 is includible in P's gross income for the taxable year closing with P's death, $15 being the difference between the option price ($85) and the fair market value of the share when the option was granted ($100), because such value is less than the fair market value at date of death ($150). The basis of the share in the hands of P's estate is determined under section 1014 without regard to the $15 includible in the decedent's gross income.

Example 8. Assume the same facts as in *Example 7*, except that P dies on August 1, 2011, at which time the share has a fair market value of $150. Although P's death occurred within six months after the transfer of the share to P, the income tax consequences are the same as in *Example 7*.

Example 9. Assume the same facts as in *Example 1*, except that the share of stock was issued in the names of P and P's spouse jointly with right of survivorship, and that P and P's spouse sold the share on June 15, 2012, for $150, its fair market value on that date. Compensation in the amount of $15 is includible in P's gross income for the year 2012, the year of the disposition of the share. The basis of the share in the hands of P and P's spouse for the purpose of determining gain or loss on the sale is $100, that is, the cost of $85 increased by the amount of $15 includible as compensation in P's gross income. The gain of $50 on the sale is treated as long-term capital gain, and is divided equally between P and P's spouse.

Example 10. Assume the same facts as in *Example 1*, except that the share of stock was issued in the names of P and P's spouse jointly with right of survivorship, and that P predeceased P's spouse on August 1, 2012, at which time the share had a fair market value of $150. Compensation in the amount of $15 is includible in P's gross income for the taxable year closing with his death. See *Example 7*. The basis of the share in the hands of P's spouse as survivor is determined under section 1014 without regard to the $15 includible in the decedent's gross income.

Example 11. Assume the same facts as in *Example 10*, except that P's spouse predeceased P on July 1, 2012. Section 423(c) does not apply in respect of the death of P's spouse. Upon the subsequent death of P on August 1, 2012, the income tax consequences in respect of P's taxable year closing with the date of P's death, and in respect of the basis of the share in the hands of P's estate, are the same as in *Example 7*. If P had sold the share on July 15, 2012 (after the death of P's spouse), for $150, its fair market value at that time, the income tax consequences would be the same as in *Example 1*.

(l) *Effective/applicability date*. Upon the date of publication of the Treasury decision adopting the rules of this section as a final regulation in the **Federal Register**, these rules will apply as of January 1, 2010.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

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Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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