

CARRYOVER ALLOCATIONS AND OTHER RULES
RELATING TO THE LOW INCOME HOUSING CREDIT

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DEPARTMENT OF THE TREASURY
26 CFR Parts 1 and 602

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Carryover Allocations and Other Rules Relating to the Low-Income Housing Credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the low-income housing credit under section 42 of the Internal Revenue Code. The regulations provide guidance with respect to: Eligibility for a carryover allocation; procedures for electing an appropriate percentage month; the general public use requirement; utility allowances to be used in determining gross rent; and the inclusion of the cost of certain services in gross rent. The regulations incorporate and expand upon the guidance provided by Notice 89-1, 1989-1 C.B. 620, and Notice 89-6, 1989-1 C.B. 625. This information will assist State and local housing credit agencies and taxpayers in complying with the requirements of section 42. The regulations affect taxpayers that apply for or claim the low-income housing tax credit and State and local housing credit agencies.

DATES: These regulations are effective May 2, 1994.

For dates of applicability of these regulations, see Sec. 1.42-12.

FOR FURTHER INFORMATION CONTACT: Christopher J. Wilson (202) 622-3040 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this final regulation have been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1102. The estimated annual burden per

State or local government respondent/recordkeeper varies from 18.60 hours to 51.63 hours, with an estimated average of 39.61 hours. The estimated annual burden for all other respondent/recordkeepers varies from 1.90 hours to 6.20 hours, with an estimated average of 4.50 hours.

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

Background

On December 29, 1992, the IRS published a notice of proposed rulemaking in the Federal Register (57 FR 61852) proposing amendments to the Income Tax Regulations (26 CFR part 1) under section 42 of the Internal Revenue Code of 1986, as amended. These amendments provide guidance on several requirements of the low-income housing tax credit and incorporate and expand upon the guidance provided by Notices 89-1 and 89-6.

Written comments responding to the notice of proposed rulemaking were received. A public hearing was scheduled for February 16, 1993, pursuant to a notice of public hearing published simultaneously with the notice of proposed rulemaking. However, the IRS received no requests to speak at the public hearing by the designated date. On February 8, 1993, the IRS published a notice (58 FR 7497) canceling the public hearing on the proposed regulations. After consideration of the comments received, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Carryover Allocations

Section 42 provides for a low-income housing credit that may be claimed as part of the general business credit under section 38. In general, the credit is allowable only to the extent that the owner of a qualified low-income building receives a housing credit

allocation from a State or local housing credit agency (Agency).

Under section 42(h)(1)(E), an allocation may be made to a qualified building that has not yet been placed in service, provided the building is placed in service not later than the close of the second calendar year following the calendar year of the allocation (a carryover allocation). Section 42(h)(1)(E)(ii) defines a qualified building as any building that is part of a project if the taxpayer's basis in the project (as of the close of the calendar year of the allocation) is more than 10 percent of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation). For these purposes, the taxpayer's basis equals the taxpayer's basis in land and depreciable property. See 2 H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. II-82 (1988), 1988-3 C.B. 572. A carryover allocation may also be made to a multiple-building project under section 42(h)(1)(F).

Commentators requested clarification on when a carryover allocation is treated as if it had never been made. The final regulations clarify that only a failure to satisfy a requirement of section 42(h)(1)(E) or (F) that must be satisfied by the close of the calendar year of allocation will cause a carryover allocation to be treated as if it had not been made.

The proposed regulations provide that a taxpayer does not have carryover-allocation basis in a project unless, by the close of the calendar year of allocation, the taxpayer is the owner, for federal income tax purposes, of land or depreciable real property expected to be part of the project. The final regulations do not explicitly contain this requirement. After further consideration, the IRS believes that satisfaction of the requirements of Sec. 1.42-6 is sufficient to ensure that a taxpayer intends to complete a qualified low-income housing project. For example, if a taxpayer has basis in land or depreciable property that is reasonably expected to be part of a project and the requirements of Sec. 1.42-6 are otherwise satisfied, the taxpayer has carryover-allocation basis with respect to the land or depreciable

property. This basis includes all items that are properly capitalizable with respect to the land or depreciable property. Thus, notwithstanding the rule in Notice 89-1 to the contrary, a nonrefundable downpayment for, or an amount paid to acquire an option to purchase, land or depreciable property may be included in carryover-allocation basis if properly capitalizable into the basis of land or depreciable property that is reasonably expected to be part of a project.

Commentators objected to the exclusion of credit application fees from carryover-allocation basis and requested that the final regulations permit these fees to be included in carryover-allocation basis. On further consideration, it appears that an absolute prohibition against the inclusion of application fees (and compliance monitoring fees, which were also not included) in carryover-allocation basis is not warranted. Accordingly, the final regulations subject credit application and compliance monitoring fees to the same standards imposed upon other fees under the regulations. For example, if a fee is properly capitalizable as part of the taxpayer's basis in land or depreciable property that is reasonably expected to be part of a project, the fee is included in carryover-allocation basis.

Verification of Basis

The proposed regulations provide verification requirements and procedures that an Agency must follow to ensure that the minimum basis requirement that is required to be met by the close of the year of allocation is, in fact, met. A commentator suggested that the basis verification requirements are too burdensome to Agencies and that Agencies lack the expertise to verify the costs includible in basis. The IRS does not expect Agencies to audit projects or make legal determinations. Rather, the proposed regulations provide that an Agency may verify the basis requirement by requiring the taxpayer to obtain a certification from an attorney or certified public accountant that the taxpayer has incurred the minimum required basis by the close of the calendar year of allocation. Accordingly, the final regulations adopt the basis verification requirement of the proposed regulations.

Requirements for Making Carryover Allocations

The proposed regulations provide guidance on the information needed for carryover allocation documents. A commentator suggested that the final regulations clarify whether a newly constructed building that receives an allocation of credit in different calendar years must have a separate Form 8609 for each allocation and, if so, whether the same building identification number (B.I.N.) should be used.

The final regulations clarify that, in this and similar situations, a separate Form 8609 is necessary for both allocations and that the B.I.N. assigned to the building for the first allocation also is used for the subsequent allocation.

Use by the General Public

The legislative history of section 42 provides that residential rental units must be for use by the general public. Residential rental units are not for use by the general public, for example, if the units are provided only for members of a social organization or provided by an employer for its employees. The proposed regulations provide an exception for an employer-provided resident manager unit that is a facility reasonably required by a project.

Commentators suggested that the exception for a resident manager unit be expanded to include a unit occupied by a full-time maintenance person. After further review, IRS the Service and the Treasury have concluded that the reference to a resident manager unit in the proposed regulations was inappropriate because the general public use requirement only applies to residential rental units. A unit that is occupied by a full-time resident manager or a full-time maintenance person is not a residential rental unit but is a facility reasonably required by a project. See Rev. Rul. 92-61, 1992-2 C.B. 7. Accordingly, the final regulations remove the reference to a resident manager unit.

Utility Allowances

A commentator suggested that the final regulations provide that in areas where there is a utility allowance increase without a corresponding increase in area median gross income, an owner may adjust the rent upwards so that rent receipts do not decrease below the minimum rent floor of section

42(g)(2)(A). Because a change of this nature requires an amendment to the statute, the final regulations do not adopt this suggestion.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of the proposed rulemaking for the regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Christopher J. Wilson, Office of the Assistant Chief Counsel (Passthroughs and Special Industries), Internal Revenue Service. However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

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

PART 1--INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * *
Sections 1.42-6, 1.42-8, 1.42-9, 1.42-10, 1.42-11, and 1.42-12 also issued under 26 U.S.C. 42(n); * * *

Par. 2. Section 1.42-6 is added, Sec. 1.42-7 is added and reserved, and Secs. 1.42-8 through 1.42-12 are added to read as follows:

Sec. 1.42-6 Buildings qualifying for carryover allocations.

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

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

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

(i) *Taxpayer must have basis in land or depreciable property related to the project.* A taxpayer has carryover-allocation basis to the extent that it has basis in land or depreciable property and the land or depreciable property is reasonably expected to be part of the project for which the carryover allocation is made. This basis includes

all items that are properly capitalizable with respect to the land or depreciable property. For example, a nonrefundable downpayment for, or an amount paid to acquire an option to purchase, land or depreciable property may be included in carryover-allocation basis if properly capitalizable into the basis of land or depreciable property that is reasonably expected to be part of a project.

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

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

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

(A) The fee is reasonable;

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

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

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

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

(3) *Reasonably expected basis.* Rules similar to the rules of paragraphs (a) and

(b) of this section apply in determining the taxpayer's reasonably expected basis in a project (land and depreciable basis) as of the close of the second calendar year following the calendar year of the allocation.

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

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

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

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

42(h)(1)(E)(ii) and paragraph (a) of this section.

Example 2. (i) *Facts.* D, an accrual-method taxpayer, receives a carryover allocation from Agency, the state housing credit agency, on September 11, 1993. As of that date, D has not begun construction of the low-income housing building D plans to build and D does not have basis in the land on which D plans to build the building. In 1993, D incurs some costs related to the planned building, including architects' fees. However, at the close of 1993, these costs do not exceed 10 percent of D's reasonably expected basis in the project.

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

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

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

is the attorney's or accountant's belief that the taxpayer has incurred more than 10 percent of its reasonably expected basis in the project by the close of the calendar year of the allocation.

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

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

(2) *Requirements for allocation.* An allocation pursuant to section 42(h)(1)

(E) or (F) is made when an allocation document containing the following information is completed, signed, and dated by an authorized official of the Agency-- (i) The address of each building in the project, or if none exists, a specific description of the location of each building;

(ii) The name, address, and taxpayer identification number of the taxpayer receiving the allocation;

(iii) The name and address of the Agency;

(iv) The taxpayer identification number of the Agency;

(v) The date of the allocation;

(vi) The housing credit dollar amount allocated to the building or project, as applicable;

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

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

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

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

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

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

(4) *Recordkeeping requirements--(i) Taxpayer.* When an allocation is made pursuant to section 42(h)(1)(E) or (F), the taxpayer must retain a copy of the allocation document and file an additional copy with the Form 8609 that is issued to the taxpayer for a building after the building is placed in service. The taxpayer need only file a copy of the allocation document with the Form 8609 for the building for the first year the credit is claimed. However, the Form 8609 must be filed for the first taxable year in which the credit is claimed and for each taxable year thereafter throughout the compliance period, whether or not a credit is claimed for the taxable year.

(ii) *Agency.* The Agency must retain a copy of the allocation document and file the original with the Agency's Form 8610 that accounts for the year the allocation is made. The Agency must also retain a copy of the Form 8609 that is issued to the taxpayer and file the original with the Agency's Form 8610 that reflects the year the form is issued.

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

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

(1) *Treatment of partnerships and other flow-through entities.* With respect to taxpayers that own projects through partnerships or other flow-through entities (e.g., S corporations, estates, or trusts), carryover-allocation

basis is determined at the entity level using the rules provided by this section. In addition, the entity is responsible for providing to the Agency the certification and documentation required under the basis verification requirement in paragraph (c) of this section.

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

Sec. 1.42-7 Substantially bond-financed buildings. [Reserved]

Sec. 1.42-8 Election of appropriate percentage month.

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

(i) Is in writing;

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

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

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

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

(2) *Effect on state housing credit ceiling.* Generally, a binding agreement described in paragraph (a)(1) of this section is an agreement by the Agency

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

(3) *Time and manner of making election.* An election under section 42(b)(2)(A)(ii)(I) may be made either as part of the binding agreement under paragraph (a)(1) of this section to allocate a specific housing credit dollar amount or in a separate document that references the binding agreement. In either case, the election must--

(i) Be in writing;

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

(iii) Be signed by the taxpayer;

(iv) If it is in a separate document, reference the binding agreement that meets the requirements of paragraph (a)(1) of this section; and

(v) Be notarized by the 5th day following the end of the month in which the binding agreement was made.

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

rescinded binding agreement, the taxpayer may elect the appropriate percentage for the month of the new binding agreement.

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

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

(6) *Procedures--(i) Taxpayer.* The taxpayer must give the original notarized election statement to the Agency before the close of the 5th calendar day following the end of the month in which the binding agreement is made. The taxpayer must retain a copy of the binding agreement and the

election statement and must file an additional copy of each with the taxpayer's Form 8609, Low-Income Housing Credit Allocation Certification, for the first taxable year in which credit is claimed for the building.

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

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

Example 1. (i) In August 1993, X and Agency enter into an agreement that Agency will allocate \$100,000 of housing credit dollar amount for the low-income housing building X is constructing. The agreement is binding and meets all the requirements of paragraph (a)(1) of this section. The agreement is a reservation of credit, not an allocation, and therefore, has no effect on the state housing credit ceiling. On or before September 5, 1993, X signs and has notarized a written election statement that meets the requirements of paragraph (a)(3) of this section. The applicable percentage for the building is the appropriate percentage for the month of August 1993.

(ii) Agency makes a carryover allocation of \$100,000 of housing credit dollar amount for the building on October 2, 1993. The carryover allocation reduces Agency's state housing credit ceiling for 1993. Due to unexpectedly high construction costs, when X places the building in service in July 1994, the product of the building's qualified basis and the applicable percentage for the building (the appropriate percentage for the month of August 1993) is \$150,000, rather than \$100,000. Notwithstanding that only \$100,000 of credit was allocated for the building in 1993, Agency may allocate an additional \$50,000 of housing credit dollar amount for the building from its state housing credit ceiling for 1994. The appropriate percentage for the month of August 1993 is the applicable

percentage for the building for the entire \$150,000 of credit allocated for the building, even though separate allocations were made in 1993 and 1994. Because allocations were made for the building in two separate calendar years, Agency must issue two Forms 8609 to X. One Form 8609 must reflect the \$100,000 allocation made in 1993, and the other Form 8609 must reflect the \$50,000 allocation made in 1994.

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

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

Example 2. (i) In September 1993, X and Agency enter into an agreement that Agency will allocate \$70,000 of housing credit dollar amount for rehabilitation expenditures that X is incurring and that X will treat as a new low-income housing building under section 42(e)(1). The agreement is binding and meets all the requirements of paragraph (a)(1) of this section. The agreement is a reservation of credit, not an allocation, and therefore, has no effect on Agency's state housing credit ceiling. On or before October 5, 1993, X signs and has notarized a written election statement that meets the requirements of paragraph (a)(3) of this section. The applicable percentage for the building is the appropriate percentage for the month of September 1993. Agency makes a carryover allocation of \$70,000 of housing credit dollar amount for the building on November 15, 1993. The carryover

allocation reduces by \$70,000 Agency's state housing credit ceiling for 1993.

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

(iii) X gives the first original notarized statement to Agency on or before October 5, 1993, and retains a copy of the first binding agreement, election statement, and carryover allocation document issued in 1993. X gives the second original notarized statement to Agency on or before November 5, 1994, and retains a copy of the second binding agreement, election statement, and carryover allocation document issued in 1994. X files a copy of the binding agreements, election statements, and carryover allocation documents with X's Forms 8609 for the first taxable year in which X claims credit for the buildings. (iv) Agency retains a copy of the binding agreements, election statements, and carryover allocation documents. Agency files the original of the first binding agreement, election statement, and 1993 carryover allocation document with its 1993 Form 8610. Agency files the original of the second binding

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

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

- (i) Be in writing;
- (ii) Reference section 42(b)(2)(A)(ii)(II);
- (iii) Specify the percentage of the aggregate basis of the building and the land on which the building is located that is financed with the proceeds of obligations described in section 42(h)(4)(A) (tax-exempt bonds);
- (iv) State the month in which the tax-exempt bonds are issued;
- (v) State that the month in which the tax-exempt bonds are issued is the month elected for the appropriate percentage to be used for the building;
- (vi) Be signed by the taxpayer; and
- (vii) Be notarized by the 5th day following the end of the month in which the bonds are issued.

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

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

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

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

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

Sec. 1.42-9 For use by the general public.

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

(b) *Limitations.* Notwithstanding paragraph (a) of this section, if a residential rental unit is provided only for a member of a social organization or provided by an employer for its employees, the unit is not for use by the general public and is not eligible for credit under section 42. In addition, any

residential rental unit that is part of a hospital, nursing home, sanitarium, lifecare facility, trailer park, or intermediate care facility for the mentally and physically handicapped is not for use by the general public and is not eligible for credit under section 42.

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

Sec. 1.42-10 Utility allowances.

(a) *Inclusion of utility allowances in gross rent.* If the cost of any utilities (other than telephone) for a residential rental unit are paid directly by the tenant(s), the gross rent for that unit includes the applicable utility allowance determined under this section. This section only applies for purposes of determining gross rent under section 42(g)(2)(B)(ii) as to rent-restricted units.

(b) *Applicable utility allowances--(1) FmHA-assisted buildings.* If a building receives assistance from the Farmers Home Administration (FmHA-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 Farmers Home Administration (FmHA) for the building. For example, if a building receives assistance under FmHA's section 515 program (whether or not the building or its tenants also receive other state or federal assistance), the applicable utility allowance for all rent-restricted units in the building is determined using Exhibit A-6 of 7 CFR part 1944, subpart E (or a successor method of determining utility allowances).

(2) *Buildings with FmHA assisted tenants.* If any tenant in a building receives FmHA rental assistance payments (FmHA tenant assistance), the applicable utility allowance for all rent-restricted units in the building (including any units occupied by tenants receiving HUD rental assistance payments) is the applicable FmHA utility allowance.

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

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

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

(B) *Utility company estimate.* Any interested party (including a low-income tenant, a building owner, or an Agency) may obtain a local utility company estimate for a unit. The estimate is obtained when the interested party receives, in writing, information from a local utility company providing the estimated cost of that utility for a unit of similar size and construction for the geographic area in which the building containing the unit is located. The local utility company estimate may be obtained by an interested party at any time during the building's extended use period (see section 42(h)(6)(D)) or, if the building does not have an extended use period, during the building's compliance period (see section 42(i)(1)). Unless the parties agree otherwise, costs incurred in obtaining

the estimate are borne by the initiating party. The interested party that obtains the local utility company estimate (the initiating party) must retain the original of the utility company estimate and must furnish a copy of the local utility company estimate to the owner of the building (where the initiating party is not the owner), and the Agency that allocated credit to the building (where the initiating party is not the Agency). The owner of the building must make available copies of the utility company estimate to the tenants in the building.

(c) *Changes in applicable utility allowance.* If at any time during the building's extended use period (or, if the building does not have an extended use period, the building's compliance period), the applicable utility allowance for a unit changes, the new utility allowance must be used to compute gross rents of rent-restricted units due 90 days after the change. 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 more than 90 days after the date of the local utility company estimate.

Sec. 1.42-11 Provision of services.

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

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

(2) *Continual or frequent services.* If continual or frequent nursing, medical, or psychiatric services are provided, it is presumed that the services are not optional and the building is ineligible

for the credit, as is the case with a hospital, nursing home, sanitarium, lifecare facility, or intermediate care facility for the mentally and physically handicapped. See also Sec. 1.42-9(b).
 (3) *Required services--(i) General rule.* The cost of services that are required as a condition of occupancy must be included in gross rent even if federal or state law requires that the services be offered to tenants by building owners.

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

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

Sec. 1.42-12 Effective dates and transitional rules.

(a) *Effective date.* The rules set forth in Secs. 1.42-6 and 1.42-8 through 1.42-12 are effective May 2, 1994. However, binding agreements, election statements, and carryover allocation documents entered into before May 2, 1994 that follow the guidance set forth in Notice 89-1, 1989-1 C.B. 620 (see Sec. 601.601(d)(2)(ii)(b) of this chapter) need not be changed to conform to the rules set forth in Secs. 1.42-6 and 1.42-9 through 1.42-12.

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

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. Part 602 is amended as follows:

1. The authority citation continues to read as follows:

Authority: 26 U.S.C. 7805.

2. Section 602.101(c) is amended by adding entries in numerical order to the table to read as follows:

Sec. 602.101 OMB control numbers.

* * * * *(c) * * * *

CFR Part or section Where identified And described	Current OMB control no.
1.42-6.....	1545-1102
1.42-8.....	1545-1102
1.42-10.....	1545-1102

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: January 25, 1994.
 Samuel Y. Sessions,
 Acting Assistant Secretary of the
 Treasury.
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