

Notice 89-6, 1989-1 CB 625--IRC Sec(s).42

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

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

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

UTILITY ALLOWANCES.

In order to qualify as a "rent-restricted unit" within the meaning of section <Page 626> 42(g) of the Code, the gross rent for such unit must not exceed 30 percent of the applicable income limitation. Failure to qualify as a rent restricted unit may result in ineligibility for the section 42 credit, reduction in the amount of the credit, and/or recapture of previously allowed credits. For this purpose, gross rent includes the cost of any utilities, other than telephone. If any utilities are paid directly by the tenant, section 42(g)(2)(B)(ii) requires the inclusion in gross rent of a utility allowance determined by the Secretary, after taking into account the procedures under section 8 of the United States Housing Act of 1937.

Regulations will provide that the owner of a HUD-regulated building--a building whose rents and utility allowances are reviewed by HUD on an annual basis--must use HUD utility allowances. For other buildings occupied by one or more tenants receiving HUD rental assistance payments ("HUD tenant assistance"), an owner must use the applicable Public Housing Authority (PHA) utility allowances established for the Section 8 Existing Housing Program. A building owner must apply FmHA utility allowances to any rent-restricted unit in a building where either the building or any tenant receives FmHA housing assistance. If a building is both HUD-regulated and FmHA assisted, then FmHA utility allowances must be used. Similarly, all low-income tenants receiving HUD rental assistance are subject to FmHA utility allowances where the building or any other tenant in the building receives FmHA assistance. For example, a low-income building receiving assistance under FmHA section 515 shall use Exhibit A-5 of FmHA Instruction 1944-E (or a successor method of determining utility allowances), regardless of whether the building is HUD regulated or any low-income tenant in the building receives HUD rental assistance. These rules will apply only for the purposes of section 42(g), and will not apply to the use of utility allowances by HUD or FmHA for their own internal purposes.

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

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

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

GENERAL PUBLIC USE REQUIREMENT.

The legislative history of section 42 of the Code provides that "Residential rental units must be for use by the general public. ... Residential rental units are not for use by the general public, for example, if the units are provided only for members of a social organization or provided by an employer for its employees." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-95 (the "Conf. Rep."), 1986-3 (Vol. 4) C.B. 95. Regulations will provide that the term "for use by the general public" shall be determined in a manner consistent with HUD housing policy governing non-discrimination as evidenced by HUD rules and regulations. See HUD Handbook 4350.3 (or its successor). Accordingly, owners of residential rental units that give preferences to certain classes of tenants (e.g., the homeless, disabled and/or handicapped) will not violate the general public use requirement if such preferences would not violate any HUD policy governing non-discrimination expressed in the HUD handbook. However, if residential rental units are restricted to a class of residents that would violate HUD housing policy (e.g., residential rental units provided solely for members of a social organization or by an employer for its employees) then the building in which these units are located will be ineligible for the credit.

PROVISION OF SERVICES.

Regulations will provide that, solely for purposes of section 42 of the Code, the furnishing to tenants of services other than housing (whether or not such services are significant) will not prevent property from qualifying as residential rental property. Regulations will also provide that, with the exception of certain federally-assisted projects for the elderly and handicapped (see below), any charges for services that are not optional to low-income tenants must be included in gross rent for purposes of section 42(g)(2)(A). A service is optional if payment for the service is not required as a condition of occupancy. Thus, in certain circumstances, a retirement-type facility may qualify under section 42 as residential rental property, notwithstanding <Page 627> that significant services other than housing are furnished to tenants. However, if continual nursing, medical, or psychiatric care is provided, it will be presumed that such services are mandatory. Such is generally the case with hospitals, nursing homes, sanitariums, and lifecare facilities.

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

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

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