Notice 89-1, 1989-1 CB 620--IRC Sec(s).42

Low-Income Housing Tax Credit--Election of Appropriate Percentage Month; Carryover of Post 1987 Low-Income Housing Credit Dollar Amounts

This Notice informs taxpayers of the requirements of two of the amendments to section 42 of the Internal Revenue Code (the Code) made by the Technical and Miscellaneous Revenue Act of 1988 (the 1988 Act) (Pub. L. 100-647). Those amendments relate to (1) an election by a taxpayer to use the appropriate percentage for a month other than the month in which a building is placed in service, and (2) carryover of post-1987 low-income housing credit dollar amounts.

ELECTION OF APPROPRIATE PERCENTAGE MONTH

Section 1002(1)(1)(A) of the 1988 Act amended section 42(b)(2)(A) of the Code to read as follows:

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.

For purposes of the election under section 42(b)(2)(A)(ii)(I) of the Code (as amended) as set forth above, an agreement between a taxpayer and a state housing credit agency is considered binding on the agency, the taxpayer, and all successors in interest if it:

(1) is in writing;

(2) specifies the housing credit dollar amount to be allocated to the building;

(3) specifies the type(s) of building(s) to which the housing credit dollar amount applies (e.g., newly constructed, existing, or substantial rehabilitation under section 42(e));

(4) is a binding contract under state law;

(5) is binding on all successors in interest to the taxpayer; and

(6) is dated and signed by the taxpayer and the agency during the month in which all the requirements of (1) through (5) are met.

A taxpayer may elect under section 42(b)(2)(A)(ii)(I) of the Code to use the appropriate percentage for a month other than the month in which a building is placed in service. If such an election is made, the applicable percentage will be the appropriate percentage for the month in which the binding agreement to allocate a specific housing credit dollar amount is made, assuming that the taxpayer has not previously made the election for a different month. Whether the appropriate percentage is the appropriate percentage for the 70 percent present value credit or the 30 percent present value credit will be determined under section 42(i)(2) when the building is placed in service. The election may be made

either as part of the binding agreement to allocate a specific housing credit dollar amount or in a separate document. A proper election under section 42(b)(2)(A)(ii)(I) must:

(1) be in writing;

(2) reference section 42(b)(2)(A)(ii)(I) of the Code;

(3) if it is in a separate document, reference the binding agreement to allocate the specific housing credit dollar amount that meets the requirements of (1) through (6) above;

(4) be signed by the taxpayer; and

(5) be notarized by the 5th day following the month in which the binding agreement was made. The notarization must be made on the last page of the election statement and may not be made on a separate page.

The original notarized document must be given to the housing credit agency before the close of the 5th calendar day of the month following the month in which the binding agreement was made. The taxpayer must retain a copy of the binding agreement and the election statement and file an additional copy with the taxpayer's Form 8609, Low-Income Housing Credit Allocation Certification, for the first taxable year in which the credit is claimed. The agency must retain a copy of the binding agreement and the election statement and file the original with the agency's Form 8610, Annual Low-Income Housing Credit Agencies Report, for the year the allocation is actually made. If the housing credit dollar amount ultimately allocated on Form 8609 differs from the amount previously agreed to in the binding agreement, an explanation should be furnished.

The housing credit dollar amount ultimately allocated to the building may not be less than the amount specified in the binding agreement, unless at the time the credit is allocated, the product of the building's actual or reasonably expected

qualified basis and the appropriate percentage for the month in which the agreement was made is less than the amount specified in the binding agreement. If, at the time of the allocation, the product of the building's actual or reasonably expected qualified basis and the appropriate percentage for the month in which the agreement was made is greater than the housing credit dollar amount specified in the binding agreement, the agency may allocate a greater credit dollar amount if there is any additional housing credit dollar amount available to allocate for the calendar year of the allocation.

Example 1.

In January 1989 the taxpayer and the state housing credit agency enter into an agreement that meets the requirements for an agreement to be binding for purposes of section 42(b)(2)(A)(ii)(I) of the Code. In the agreement, the state housing credit agency agrees to allocate $100,000 of housing credit dollar amount to the low-income housing building being constructed by the taxpayer. This amount will be deducted from the state housing credit ceiling only during the calendar year in which the allocation is actually made. Before February 5, 1989, an election statement that meets the requirements for an election under section 42(b)(2)(A)(ii)(I) is signed by **<Page 621>** the taxpayer and is notarized so that the applicable percentage for the building will be the appropriate percentage for the month of January 1989. When the building is placed in service in August 1989, the product of the building's qualified basis and the appropriate percentage for the month of January 1989 is $150,000, rather than $100,000. Under the agreement the agency must allocate $100,000 of housing credit dollar amount. However, the agency may also allocate an additional $50,000 of housing credit dollar amount from its state housing credit fund for calendar year 1989 if the agency has credit available to allocate. The appropriate percentage for the month of January 1989 is the appropriate percentage to be used for the building, despite the fact that more housing credit dollar amount is allocated to the building when the building is placed in service than was previously agreed. Because the

allocation of the $100,000 of housing credit dollar amount under the agreement and the $50,000 of additional housing credit dollar amount are made during the same calendar year, only one Form 8609 for the total amount allocated to the building must be completed.

The election under section 42(b)(2)(A)(ii)(II) of the Code pertains to buildings that are 70 percent or more financed by tax-exempt bonds subject to the volume cap of section 146. For those buildings, taxpayers may elect to apply the appropriate percentage for the month in which the tax-exempt bonds are issued. A proper election under section 42(b)(2)(A)(ii)(II) must:

(1) be in writing;

(2) reference section 42(b)(2)(A)(ii)(II) of the Code;

(3) specify the percentage of the aggregate basis of the building and the land on which the building is located that is financed by tax-exempt bonds subject to the volume cap of section 146;

(4) state the month in which the tax-exempt bonds are issued;

(5) state that the month in which the tax-exempt bonds are issued is the month elected for the appropriate percentage with respect to the building;

(6) be signed by the taxpayer; and

(7) be notarized by the 5th day following the month in which the bonds are issued. The notarization must be made on the last page of the election statement and may not be made on a separate page.

The taxpayer must provide the original notarized statement to the state housing credit agency before the close of the 5th calendar day of the month following the month in which the bonds are issued. If an agency, other than the state housing

credit agency, issues the tax-exempt bonds, the taxpayer must also provide the state housing credit agency with a signed statement from the issuing authority that certifies the material in items (3) and (4). The taxpayer must retain a copy of the election statement and file an additional copy with the taxpayer's Form 8609 for the first taxable year in which the credit is claimed. The agency must retain a copy of the election statement and file the original with the agency's Form 8610 for the year an allocation is made.

Example 2.

A taxpayer plans to rehabilitate a low-income housing building in which 60 percent of the aggregate basis of the building and the land on which such building is located is financed by tax-exempt bonds subject to the volume cap under section 146 of the Code. The building does not meet the requirements of section 42(h)(4)(B) because less than 70 percent of such aggregate basis is financed by tax-exempt bonds subject to the volume cap under section 146. Therefore, the taxpayer may not elect under section 42(b)(2)(A)(ii)(II) to have the appropriate percentage for the month the tax-exempt bonds are issued apply to the low-income housing building. However, the taxpayer may enter into a binding agreement with the state housing credit agency under section 42(b)(2)(A)(ii)(I) as to the housing credit dollar amount to be allocated to the building and may elect to have the appropriate percentage for the month of the agreement apply to the building, assuming that no previous binding agreement exists as to the housing credit dollar amount to be allocated to the building.

If, under state law, a binding agreement for a specific housing credit dollar amount becomes null and void, and the taxpayer enters into another binding agreement for a specific housing credit dollar amount, the taxpayer may elect under section 42(b)(2)(A)(ii)(I) of the Code to apply the appropriate percentage for the month of the new binding agreement, assuming no such election was made with regard to the previous binding agreement.

If a taxpayer and the state housing credit agency entered into a binding agreement (which is still in effect under state law) for a specific housing credit dollar amount during calendar year 1988, the taxpayer may elect the appropriate percentage for the month in which the binding agreement was made by making an election statement in accordance with the requirements of this Notice before January 6, 1989.

If a taxpayer wishes to rely on a binding agreement or an election statement made prior to the date of release of this Notice, the taxpayer may do so if both such agreement and election statement (or solely the election statement in the case of an election made pursuant to section 42(b)(2)(A)(ii)(II) of the Code) are modified to conform to the requirements of this Notice before January 6, 1989. Such modified agreement and election statement shall relate back to the month in which the binding agreement was originally made or the month in which the tax-exempt bonds were issued, as appropriate. With respect to agreements made after December 31, 1988, and tax-exempt bonds issued after such date, the taxpayer has until the close of the 5th day after the month in which the agreement was made or the tax-exempt bonds were issued to elect to apply the appropriate percentage.

CARRYOVER OF POST-1987 LOW-INCOME HOUSING CREDIT DOLLAR AMOUNTS

Sections 1002(l)(14)(A) and 4003 of the 1988 Act amended section 42(h)(1) of the Code dealing with the allocation of housing credit dollar amounts by state housing credit agencies. Section 4003(a) provides an additional exception to the general rule in section 42(h)(1)(B) that allocations by state housing credit agencies must be made not later than the close of the calendar year in which a building is placed in service. The exception, which applies to "qualified buildings" not yet placed in service, is contained in section 42(h)(1)(E) and permits a

qualified building to be placed in service in the year in which an allocation is received or in either of the 2 succeeding calendar years.

Section 42(h)(1)(E)(ii) of the Code defines a qualified building for purposes of section 42(h)(1)(E)(i) as any building that is part of a project if the taxpayer's basis in the project (as of the end of the **<Page 622>** calendar year in which the allocation is made) is more than 10 percent of the taxpayer's reasonably expected basis in the project (as of the end of the second calendar year succeeding the allocation year).

The following rules shall apply for purposes of the 10 percent basis exception in section 42(h)(1)(E) of the Code:

(1) Basis means the adjusted basis of land and depreciable real property, whether or not such amounts are includable in eligible basis; however, an allocation pursuant to section 42(h)(1)(E) of the Code is based upon items includable in eligible basis.

(2) A taxpayer has basis in land and other acquired real property when the benefits and burdens of ownership have been transferred to the taxpayer. In the case of purchased property, this transfer normally occurs at closing. For example, amounts paid to acquire an option to purchase land or a building are not includable in basis because the full benefits and burdens of ownership have not been transferred to the taxpayer; nor have the benefits and burdens of ownership been transferred merely because a nonrefundable downpayment is made.

(3) Whether a taxpayer has basis in construction costs depends upon the method of accounting used by the taxpayer. For example, the cost of construction services is included in the basis of an accrual method taxpayer when the services are performed, and in the basis of a cash method taxpayer when the bill for such services is paid.

(4) With respect to taxpayers who are members of partnerships or other flow-through entities, the accounting method of the flow-through entity shall be applied to determine whether the 10 percent exception applies.

Application of the foregoing rules may result in an answer different from that required by section 42(n) of the Code as it existed prior to the passage of the 1988 Act as interpreted by Notice 88-116. To the extent that the provisions of Notice 88-116 are inconsistent with this notice, Notice 88-116 is superseded.

Generally, an allocation is made when a state housing credit agency issues a Form 8609 to the taxpayer. However, an allocation pursuant to section 42(h)(1)(E) of the Code is an exception to this general rule. When an allocation is made pursuant to section 42(h)(1)(E), a Form 8609 is not issued by the state housing credit agency until the calendar year in which the building is placed in service. State housing credit agencies are responsible for issuing Forms 8609 to taxpayers in the calendar years that buildings are placed in service even if such years are later than the calendar years in which allocations are made pursuant to section 42(h)(1)(E). Thus, even though the state housing credit ceiling is zero for any calendar year after 1989, agencies are required to issue Forms 8609 after that date to taxpayers that received allocations pursuant to section 42(h)(1)(E) and placed buildings in service after December 31, 1989.

An allocation pursuant to section 42(h)(1)(E) of the Code reduces the state housing credit ceiling for the year in which the allocation is made, whether or not a Form 8609 is issued that year.

An allocation pursuant to section 42(h)(1)(E) of the Code is made when an allocation document containing the following information is completed, signed and dated by an authorized official of the housing credit agency:

(1) the address of the building, or if none exists, a specific description of its location;

(2) the name, address, and taxpayer identification number of the building owner receiving the allocation;

(3) the name and address of the housing credit agency;

(4) the taxpayer identification number of the agency;

(5) the date of the allocation;

(6) the housing credit dollar amount allocated to the building;

(7) the taxpayer's total reasonably expected basis in the project;

(8) the taxpayer's basis in the project as of the close of the calendar year in which the allocation is made and the percentage such basis bears to the total reasonably expected basis in the project;

(9) the expected date that the building will be placed in service; and

(10) the Building Identification Number (B.I.N.) to be assigned to the building when the building is placed in service. The B.I.N. should reflect the year the allocation is made, rather than the year the building is placed in service, unless the building is placed in service during the allocation year.

A building receiving an allocation pursuant to section 42(h)(1)(E) of the Code must be placed in service no later than the close of the second calendar year following the calendar year in which the allocation is made. If a building does not receive an allocation pursuant to section 42(h)(1)(E), the building must be placed in service by December 31, 1989, even if all or a portion of the building is financed with tax-exempt debt. Therefore, any building that is to be placed in service after December 31, 1989, must receive an allocation of credit pursuant to section 42(h)(1)(E) before the housing credit agency's authority to allocate credit expires.

When an allocation is made pursuant to section 42(h)(1)(E) of the Code, 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 during the calendar year that the building is placed in service. Form 8609 must be filed for the first taxable year in which the credit is claimed. The agency must retain a copy of the allocation document and file the original with the agency's Form 8610, for the year an allocation is made.

If a taxpayer receives an allocation under section 42(h)(1)(E) of the Code 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 the building is placed in service, the requirements specified above for an effective election under section 42(b)(2)(A)(ii) must also be met.

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.