

## **PURPOSE**

The Internal Revenue Service has published a safe harbor guideline (or instructions) for the use by IRS determination specialists or tax law specialists in the processing of applications for recognition of exemption of organizations that provide low-income housing. The guideline was published in the Internal Revenue Manual by Manual Transmittal 7600-92, dated October 16, 1992. In light of the concern expressed by some exempt organizations with the effect of the guideline on their continued qualification for recognition of exemption, we are reprinting the guideline here and clarifying the effect of the guideline.

## **BACKGROUND**

The guideline provides instruction in the processing of exemption applications under section 501(c)(3) of the Internal Revenue Code of organizations that provide low-income housing. The guideline establishes a safe harbor for those organizations that rely on the relief of the poor and distressed under section 1.501(c)(3)-1- (d)(2) of the Income Tax Regulations as the basis for exemption.

Without use of the guideline, an organization must demonstrate that the housing recipients are poor and distressed by reference to all the surrounding facts and circumstances. This requires a showing that the recipients are unable to afford the basic necessities of life, including safe and decent housing, without undue hardship.

Non-profit organizations providing low income housing have long demonstrated that they may be described in section 501(c)(3) of the Code by reference to the facts and circumstances. The safe harbor guideline is merely a method to provide a convenience to the Service in the administration of the tax code and to provide organizations with certainty in establishing exemption qualification. It is

not meant to replace the use of facts and circumstances. Organizations that have ruling or determination letters and have not materially changed their organization or operation can continue to rely on those letters.

## SAFE HARBOR GUIDELINE

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### Safe Harbor Guideline for Low Income Housing

(1) This guideline is intended to assist in the processing of exemption applications under IRC 501(c)(3) for organizations that provide low income housing.

(2) Rev. Rul. 70-585, 1970-2 C.B. 115, Situation 1, holds that an organization formed to develop a program to provide housing not otherwise affordable to low income families is relieving the poor and distressed; therefore, it is operated exclusively for charitable purposes. Whether an organization that provides housing for the poor qualifies for exemption under IRC 501(c)(3) is determined by all the facts and circumstances which demonstrate that recipients of the organization's assistance are poor and distressed or underprivileged within the meaning of Regs. 1.501(c)(3)-1-(d)(2). Affordable housing provided to persons who are not poor or otherwise members of a charitable class does not further exempt purposes; rather, it furthers private interests. Rev. Rul. 70-585, Situation 4, holds that a nonprofit housing organization created to aid moderate income families does not qualify for exemption since its program is not designed to provide relief to the poor or to carry out any other charitable purpose. Nevertheless, inclusion of some persons who are not poor and distressed or underprivileged in a housing project for the poor may indirectly advance charitable purposes by providing some degree of stability, resource and role model function. Thus, there is some question about who is poor and the

numbers, if any, of persons who are not poor who may be aided by a housing organization whose exempt purpose is based on relieving poverty.

(3) The Service has long held that poor means needy in the sense that a person cannot afford the basic necessities of life without assistance, including safe and sanitary housing. Thus, Rev. Rul. 70- 585 makes clear that use of the term "low income" is not determinative of whether an organization's housing program is charitable. The ruling points out that the recipients are persons who could not afford housing without assistance, not merely persons of low income. The ruling also points out that housing is affordable where the project is financed by contributions, funds obtained under Federal and State housing programs, or volunteer labor, and is offered at or below cost.

(4) The figures employed in the guideline are derived from the IRC 42 low income housing credit, the IRC 145(d) and 142(d) tax exempt bond provisions for qualified residential projects, and the Department of Housing and Urban Development ("HUD") Public Housing and Section 8 programs. Housing projects that set aside units for those who earn 50 percent or 60 percent of an area's median income, depending on the number of units set aside, qualify under IRC 42 and IRC 145(d) and 142(d). In addition, HUD's Public Housing and Section 8 programs are available for very low income families whose incomes do not exceed 50 percent of the median family income for the area. Furthermore, under HUD's Public Housing and Section 8 programs, HUD has the authority to grant a variance to some housing projects and allow a maximum of 25 percent occupancy by persons at low income levels whose incomes do not exceed 80 percent of the median family income for the area.

(5) As an administrative convenience so that organizations may plan housing programs with some assurance, an organization's provision of housing to some persons who are not members of a charitable class will be treated as relieving the poor and distressed or underprivileged for purposes of qualifying for

exemption under IRC 501(c)(3) if the housing falls within the safe harbor guideline.

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#### Safe Harbor Guideline

An organization will meet the safe harbor guideline if it establishes that at least 75 percent of the units for a given project will be made available for families earning 60 percent or less of the area's median income, as adjusted for family size. Concerning the remaining 25 percent of the units, if any, the organization must adopt a general policy which states that the remaining units will be made available to persons on the lower end of the economic spectrum, yet who may not necessarily be members of a charitable class.

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#### Applying the Guideline

(1) Solely for purposes of applying this guideline, median income for an area is accepted as determined by HUD. HUD collates such information under the name "HUD Section 8 Income Limits." Copies of HUD's section 8 income limits for either the entire country or specific areas may be obtained by calling HUD at (800) 245-2691. (A small fee is required HUD to cover costs of reproduction.

(2) Providing assistance to aged, physically handicapped, or others either because they are (a) poor and distressed or underprivileged, or (b) under a program which otherwise qualifies as charitable, can be included in meeting the above referenced 75 percent safe harbor. Examples of programs for the elderly and the handicapped held to further exempt purposes are set forth in Revenue Rulings 79-18 and 79-19, 1979-1 C.B. 194.

(3) As noted in the guideline, an organization may provide up to 25 percent of its housing to persons who do not necessarily represent a charitable class. The 25 percent guideline figure does not represent an incidental amount. The provision of some housing to persons who earn above 60 percent of an area's median income will be treated as supporting an organization's charitable program of providing a decent living environment for the poor and distressed provided such housing satisfies the safe harbor.

(4) Exemption is not precluded for organizations that provide housing but do not satisfy the safe harbor. For these organizations, consideration will be given to all the facts and circumstances of the particular case (e.g., percentage of poor residents; an actual showing that the persons aided could not otherwise secure housing; retention of residents who initially were poor notwithstanding an increase in income consistent with federal, state or local housing programs; and any other special circumstance for not satisfying the safe harbor).

(5) If the low income housing project retains the right to evict tenants for failure to pay rent, such fact, in and of itself, will not defeat exemption, provided the overall charitable nature of the housing project is not disturbed. However, for organizations providing assistance to the elderly or the handicapped, a right to evict for failure to pay rent could adversely affect their qualification for exemption. Rev. Ruls. 79-18 and 79-19 require such organizations to adopt a policy to provide for the financial security of the elderly or the handicapped by retaining residents to the extent financially feasible.

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#### Other Considerations

(1) Revenue Ruling 70-585, sets forth several situations in which housing may further exempt purposes other than by providing affordable housing to low income families. Situation 2 describes the provision of housing to eliminate

prejudice and discrimination and lessen neighborhood tensions by offering affordable housing to minority families of low and moderate income who are unable to obtain adequate housing because of local discrimination. Situation 3 describes the provision of housing to combat community deterioration by offering affordable housing to low and moderate income residents of a deteriorated area of a city undergoing redevelopment where the median income level is lower than other areas and the residents undertake an initiative to ensure themselves decent housing without undergoing relocation.

(2) Even if an organization satisfies the safe harbor guideline, it may fail to qualify for exemption because private interests of individuals with a financial stake in the project are furthered. For example, the role of any private developer or management company must be carefully scrutinized to ensure the absence of unreasonable land sales, development fees, or management contracts. A community based board of directors would be a significant factor in determining the likelihood that a housing organization's activities serve public rather than private interests.

## **PUBLIC COMMENTS**

Although this guideline is in effect, we will modify it as additional issues are identified and as we gain experience in reviewing the application of the guideline. Because public input is helpful in this process, interested parties are invited to submit comments, in writing, on the safe harbor guideline including comments on other safe harbor provisions that may be useful in processing applications of low-income housing organizations. If warranted, after consideration of the comments received, the Service will schedule a public hearing to discuss any changes to the guideline.

The response date for comments is 60 days from the date of appearance of this notice in the Internal Revenue Bulletin. Comments should be addressed to:

Internal Revenue Service

Assistant Commissioner (Employee

Plans and Exempt Organizations)

Attention: E:EO:R:1, Room 6516

1111 Constitution Ave.

Washington, D.C. 20224

The principal authors of this notice are Lynn Kawecki and Marvin Friedlander, Exempt Organizations Technical Division. For further information contact Lynn Kawecki at (202) 622-7728 (not a toll-free call) or Marvin Friedlander at (202) 622-8715 (not a toll-free call).