

26 CFR 1.601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability  
(Also: Part I, Sections 42; 1.42-5, 1.42-5T)

Rev. Proc. 2016-15

## SECTION 1. PURPOSE

This revenue procedure sets forth, for purposes of § 1.42-5T(c)(2)(iii)(B) of the Income Tax Regulations, the minimum number of low-income units in a low-income housing project for which a State or local housing credit agency (Agency) must conduct physical inspections and low-income certification reviews. This revenue procedure also permits the physical inspection protocol established by the Department of Housing and Urban Development (HUD) Real Estate Assessment Center (the REAC protocol) to satisfy the physical inspection requirements of § 1.42-5(d) and § 1.42-5T(c)(2)(ii) and (iii).

## SECTION 2. BACKGROUND

.01 Section 42 of the Internal Revenue Code provides rules for determining the amount of the low-income housing credit, which is allowed as a credit against income tax under section 38. A low-income unit is a residential unit that is rent-restricted and whose occupants meet the applicable income limit elected by the taxpayer as described in section 42(g)(1)(A) or (B).

.02 Under section 42(i)(3)(B)(i), a low-income unit is not treated as a low-income unit unless it is suitable for occupancy and used other than on a transient basis. Under section 42(i)(3)(B)(ii), the suitability of a unit for occupancy must be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes. Failure of one or more units to qualify as low-income units may result in a low-income housing project's ineligibility for the low-income housing credit, reduction in the amount of the credit, and/or recapture of previously allowed credits.

.03 Section 1.42-5 of the Income Tax Regulations provides procedures that an Agency (or its Authorized Delegate within the meaning of §1.42-5(f)(1)) must follow in monitoring for compliance with the provisions of section 42.

.04 Section 1.42-5T(c)(2)(ii) requires an Agency to conduct on-site inspections and perform low-income certification review (including documentation supporting the low-income certifications and the rent records for tenants) for each low-income housing project.

.05 Section 1.42-5T(c)(2)(iii) requires an Agency to conduct on-site inspections that satisfy the requirements of both § 1.42-5(d) and § 1.42-5T(c)(2)(iii)(A)-(D) (relating to timing, number of low-income units, manner of selection, and method of review) and to perform low-income certification review that satisfies the requirements of § 1.42-5T(c)(2)(iii)(A)-(D).

.06 Section 1.42-5T(c)(2)(iii)(A) requires an Agency to conduct on-site inspections of all buildings in a low-income housing project and review low-income certifications by the end of the second calendar year following the year the last building in the project is placed in service and at least once every 3 years thereafter.

.07 Section 1.42-5T(a)(2)(iii) provides that guidance published in the Internal Revenue Bulletin may provide alternative means of satisfying the requirements of §§ 1.42-5(a)(2)(i) and 1.42-5T and may provide exceptions from those provisions. Section 1.42-5T(c)(2)(iii)(B) provides that an Agency must conduct on-site inspections and low-income certification review of no fewer than the minimum number of low-income units required by guidance published in the Internal Revenue Bulletin.

.08 Section 1.42-5T(c)(2)(iii)(C) requires an Agency to select the low-income units for purposes of on-site inspections and low-income certification review in a random manner. The Agency must select the low-income units to inspect and low-income certifications to review in a manner that will not give advance notice that a low-income unit or low-income certifications for a particular year will or will not be inspected or reviewed. However, the Agency may give an owner reasonable notice that an inspection of the building and low-income units or review of low-income certifications will occur so that the owner may notify tenants of the inspection or assemble low-income certifications for review. Section 1.42-5T(c)(2)(iii)(C)(3) provides rules for determining the meaning of “reasonable notice.”

.09 An Agency does not need to select the same low-income units for on-site inspections and low-income certification review. If the Agency chooses to select different low-income units for on-site inspections and low-income certification review, the Agency must select the units for on-site inspections or low-income certification review separately and in a random manner. An Agency may choose a different number of units for on-site inspections and low-income certification review, provided the Agency chooses at least the minimum number of low-income units in each case.

.10 Any pattern of overlap or non-overlap of the units selected for inspection and the units selected for low-income certification review must not violate § 1.42-5T(c)(2)(iii)(C)(2) (which limits advance notification to reasonable notice of which units will be subject to inspection or low-income certification review). Thus, if the Agency chooses to select the same units for on-site inspections and low-income certification review, the Agency may conduct on-site inspections and low-income certification review either at the same time or separately, but within the reasonable-notice period. This period starts to run on the date the Agency informs the owner of the identity of the units for which on-site inspections or low-income certification review will occur.

### SECTION 3. SCOPE

This revenue procedure applies for determining whether compliance-monitoring provisions meet the requirements of §§ 1.42-5(d) and 1.42-5T(c)(2)(ii) and (iii).

### SECTION 4. NUMBER OF LOW-INCOME UNITS FOR INSPECTION AND LOW-INCOME CERTIFICATION REVIEW

The minimum number of low-income units for which an Agency must conduct on-site inspections and low-income certification review is the lesser of (1) or (2) below—

- (1) 20 percent of the low-income units in the low-income housing project, rounded up to the nearest whole number of units, or
- (2) the Minimum Unit Sample Size set forth in the following Low Income Housing Credit Minimum Unit Sample Size Reference Chart:

<b>Number of Low-Income Units in the Low-Income Housing Project</b>	<b>Number of Low-Income Units Selected for Inspection or Low- Income Certification Review (Minimum Unit Sample Size)</b>
1	1
2	2
3	3
4	4
5-6	5
7	6
8-9	7
10-11	8
12-13	9
14-16	10
17-18	11
19-21	12
22-25	13
26-29	14
30-34	15
35-40	16
41-47	17
48-56	18
57-67	19
68-81	20
82-101	21
102-130	22
131-175	23
176-257	24
258-449	25
450-1,461	26
1,462-9,999	27

**SECTION 5. INSPECTION STANDARD—USE OF THE REAC PROTOCOL**

.01 The REAC protocol is among the inspection protocols that satisfy both § 1.42-5(d) and the physical inspection requirement of § 1.42-5T(c)(2)(ii) and (iii). This revenue procedure treats an inspection as being performed under the REAC protocol only if the inspection satisfies all of the following requirements:

- (1) Both vacant and occupied low-income units in a low-income housing project are included in the population of units from which units are selected for inspection.<sup>1</sup>
- (2) The inspection complies with the procedural and substantive requirements of the HUD Real Estate Assessment Center (REAC), including the requirement to use the most recent REAC Uniform Physical Condition Standards (UPCS) inspection software (or software that is accepted by HUD).<sup>2</sup>
- (3) The inspection is performed by HUD REAC inspectors (or inspectors certified by HUD).
- (4) The inspection results are sent to HUD, the results are reviewed and scored within HUD's secure system without any involvement of the inspector who conducted the inspection, and HUD makes its inspection report available.

.02 If, consistent with Section 5.01 of this revenue procedure, an Agency conducts on-site inspections under the REAC protocol—

- (1) § 1.42-5T(c)(2)(iii)(A) is applied as if it did not contain the word “all”;
- (2) The number of low-income units required to be inspected under the REAC protocol satisfies the requirements of § 1.42-5T(c)(2)(iii)(B)

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<sup>1</sup> For low-income units, including vacant units, that do not pass inspection under the REAC protocol, it may be possible to correct the noncompliance and avoid loss of credits or recapture. See §1.42-5(e)(4).

<sup>2</sup> The HUD REAC requires the use of the REAC sampling methodology, which is incorporated in the REAC UPCS inspection software. However, mere use of the public version of the REAC UPCS inspection software is not, by itself, sufficient to qualify as use of the REAC protocol.

(concerning the number of low-income units an Agency must inspect);

and

- (3) The manner in which the low-income units are selected for inspection under the REAC protocol satisfies the requirements of § 1.42-5T(c)(2)(iii)(C).

.03 Conducting on-site inspections under the REAC protocol does not excuse an Agency from reviewing low-income certifications in accordance with § 1.42-5T(c)(ii) and (iii).

#### SECTION 6. EFFECTIVE DATE

This revenue procedure is effective on February 25, 2016. Agencies using the REAC protocol as part of the Physical Inspections Pilot Program, however, may rely on these provisions for on-site inspections and low-income certification review occurring between January 1, 2015 and February 25, 2016.

#### SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Jian H. Grant and Martha M. Garcia of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, please contact Ms. Grant at (202) 317-4137 or Ms. Garcia at (202) 317-6853 (not toll free numbers).