

Rev. Rul. 76-75

1976-1 C.B. 14

Section 61

Section 163

IRS Headnote

Interest reduction payments under National Housing Act. Interest reduction payments made under section 236 of the National Housing Act to a mortgagee on behalf of a limited-profit corporation formed to acquire and lease apartments in a lower income rental housing project are includible in the corporation's gross income and the corporation is entitled to deduct the full amount of interest paid under the mortgage.

Full Text

Rev. Rul. 76-75

Advice has been requested as to the treatment for Federal income tax purposes of interest reduction payments made on behalf of a taxpayer, a limited-profit corporation, under the circumstances described below.

The taxpayer is a limited-profit corporation formed under the limited-profit housing laws of a state to acquire and lease apartments in a lower income rental housing project. Under the state law, the taxpayer's profits and dividend distributions or disbursements from surplus cash are limited.

Section 236 of the National Housing Act, as amended, 12 U.S.C. 1715z-1, provides that for the purpose of reducing rentals for lower income families, the Secretary of the Department of Housing and Urban Development is authorized to make, and to contract to make, periodic interest reduction payments on behalf of the owner of a rental housing project designed for occupancy by lower income families. The interest reduction payments are made to mortgagees holding mortgages that meet the special requirements specified in section 236.

To qualify for the benefits provided under section 236, the housing project must be subject to a mortgage that is insured by the Federal Housing Administration of the Department of Housing and Urban Development, or if the project is subject to a mortgage that is not so insured, such project must be financed under a state or local program providing assistance through loans, loan insurance, or tax abatements, and that may involve either new or existing construction that is approved for receiving such benefits.

Since the lower income family only pays a minimum basic rental or 25 percent of income, if greater, and not the fair rental value necessary to cover the payment of principal, interest, taxes, insurance, maintenance of the property, and a limited profit, the Federal Government makes interest reduction payments to the mortgagee to make up the difference between what the lower

income family pays and the fair rental value. The Government assistance together with the basic rental paid by the lower income family is then sufficient to enable the mortgagor/lessor to pay the principal, interest, and other charges and, in addition, earn a limited profit.

Whether a family is to be eligible for admission to such a project as a tenant who cannot afford the fair rental is determined by the Secretary of the Department of Housing and Urban Development within the provisions of section 236.

The mortgagor must verify the adjusted income certified by prospective tenants for initial occupancy, and by present tenants for continuing subsidized occupancy. The mortgagor must also require tenants to recertify their income periodically and make appropriate adjustments in rental charges to reflect changes in the tenant's adjusted income. At such time as the tenant's income is sufficient to pay a market rate rental the tenant will be required to do so.

In any case where units are occupied by families who pay a rental in excess of the basic amount, the excess is to be remitted by the mortgagor/lessor to the Department of Housing and Urban Development.

Interest reduction payments made to a mortgagee on behalf of a mortgagor shall be in an amount not exceeding the difference between the monthly payment for principal, mortgage insurance premium, and interest which the mortgagor is obligated to pay under the mortgage and the monthly payment for principal and interest such mortgagor would be obligated to pay if the mortgage were to bear interest at the rate of 1 percent per annum. With respect to each monthly payment made under the terms of the mortgage, the Department of Housing and Urban Development will pay directly to the mortgagee an amount prescribed under section 236, and the mortgagor will pay to the mortgagee the difference between the amount required under the mortgage terms and the Government payment.

Section 61 of the Internal Revenue Code of 1954 provides that gross income means all income from whatever source derived, unless otherwise excluded by law. Section 163 of the Code allows as a deduction in computing taxable income all interest paid or accrued within the taxable year on indebtedness.

The interest reduction payments made to the mortgagee by the Department of Housing and Urban Development under section 236 on behalf of the taxpayer represent payments by the Government for the benefit of the tenant of a portion of what otherwise would be the fair rental value of the space the tenant occupies. Thus, such payments are treated as if they were received by the taxpayer as rent and subsequently paid to the mortgagee as part of the interest due under the mortgage obligation.

Accordingly, the interest reduction payments made by the Department of Housing and Urban Development to the mortgagee are includible in the gross income of the taxpayer. Compare Rev. Rul. 75-271, 1975-2 C.B. 23, which holds that assistance payments made to the mortgagee on behalf of low income homeowners by the Department of Housing and Urban Development under section 235 of the National Housing Act, as amended, are not includible in the gross income of the individual homeowner since such payments are in the nature of general welfare.

Further, the total amount of the interest paid under the mortgage, including the portion of such interest paid by the Department of Housing and Urban Development, is deductible by the mortgagor/taxpayer as interest within the meaning of section 163 of the Code. The taxpayer's basis in the property is not reduced as a result of any interest reduction payments made by the Department of Housing and Urban Development.