*Credit percentage*

For buildings placed in service in 1987, the credit percentages are 9 percent annually over 10 years for the 70-percent present value credit, and 4 percent annually over 10 years for the 30-percent present value credit.

For buildings placed in service after 1987, these credit percentages are to be adjusted monthly by the Treasury Department to reflect the present values of 70 percent and 30 percent at the time the building is placed in service. Treasury's monthly adjustments of the credit percentages are to be determined on a discounted after-tax basis, based on the average of the annual applicable Federal rates (AFR) for mid-term and long-term obligations for the month the building is placed in service. The after-tax interest rate is to be computed as the product of (1) the average AFR and (2) .72 (one minus the maximum individual Federal income tax rate). The discounting formula assumes each credit is received on the last day of each year and that the present value is computed as of the last day of the first year. For example, if 72 percent of the average AFR for a given month were 5.85 percent, the 70-percent and 30-percent present value credit percentages for buildings placed in service in that month would be 8.92 percent and 3.82 percent. (For the 70-percent present value credit, this is derived as $.0892 = (.70)(.0585)/[1.0585-1/(1.0585)^{9}]$.) In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.[4]

For buildings originally placed in service after 1987, Congress intended that the taxpayer, with the consent of the housing credit agency, may irrevocably elect to use the credit percentage determined using the above method for the month in which the taxpayer receives a binding commitment for a credit allocation from the credit agency or, in the case of a tax-exempt bond financed project for which no allocation is required, the month in which the tax-exempt bonds are issued.[5]

The credit percentage for rehabilitation expenditures (in excess of a prescribed minimum amount) is determined when rehabilitation is completed and the rehabilitated property is placed in service, but no later than the end of the 24-month period for which such expenditures may be aggregated.[6] These rehabilitation expenditures are treated as a separate new building for purposes of the credit.

The credit percentage for rehabilitation expenditures that are incurred in connection with the acquisition of an existing building (and which do not exceed prescribed minimum amounts) is the same percentage as is used for the acquired building, i.e., the per-

[4] As discussed below, a credit percentage equal to two-thirds of the credit percentage for the initial qualified basis is applicable to additions to qualified basis.

[5] A technical amendment may be needed so that the statute reflects this intent and the intent of Congress that such an election would be binding on the taxpayer and all successors in interest.

[6] Congress intended that the election to determine the credit percentage at the time a binding commitment for a credit allocation is received, described above, also apply in the case of credits attributable to rehabilitation expenditures (in excess of a prescribed minimum amount). A technical amendment may be needed so that the statute reflects this intent.

centage determined when the acquired building is placed in service.

### *Qualified basis*

#### *In general*

The qualified basis amounts with respect to which the credit amount is computed are determined as the proportion of eligible basis in a qualified low-income building attributable to the low-income rental units. This proportion is the lesser of (1) the proportion of low-income units to all residential rental units or (2) the proportion of floor space of the low-income units to the floor space of all residential rental units. Generally, in these calculations, low-income units are those units presently occupied by qualifying tenants, whereas residential rental units are all housing units, whether or not presently occupied.

The qualified basis for each building is determined on the last day of each taxable year, beginning in the taxable year in which the building is placed in service or, if the taxpayer elects, the following taxable year.

#### *Special rules for determining qualified basis*

The Treasury Department may provide regulations for projects consisting of two or more buildings. Unless prescribed in regulations, the qualified basis of a project consisting of two or more buildings is determined separately for each building. Common facilities in such a project must be allocated in an appropriate manner to all buildings (whether existing or to be constructed) in the project.

The first year the credit is claimed, the allowable credit amount is determined using an averaging convention to reflect the number of months units comprising the qualified basis were occupied by low-income individuals during the year. For example, if half of the low-income units included in qualified basis were first occupied in October and the remaining half were occupied in December, a calendar year taxpayer would adjust the allowable first-year credit to reflect that these units were occupied on average only one-sixth of the year. To the extent there is such a reduction of the credit amount in the first year, an additional credit in the amount of such reduction is available in the eleventh taxable year. (This first-year adjustment does not affect the amount of qualified basis with respect to which the credit is claimed in subsequent years of the 10-year credit period.)

#### *Additions to qualified basis*

The qualified basis of a building may be increased subsequent to the initial determination only by reason of an increase in the number of low-income units or in the floor space of the low-income units (as opposed to by reason of increases in the eligible basis). Credits claimed on such additional qualified basis are determined using a credit percentage equal to two-thirds of the applicable credit percentage allowable for the initial qualified basis. As described below under the description of the State credit ceiling, an allocation of credit authority must be received for credits claimed on additions to qualified basis, in the same manner as for credits claimed on the initial qualified basis. Unlike credits claimed on the initial qualified basis, credits claimed on additions to qualified basis are allowable annually for the portion of the required 15-year compliance period remaining after eligibility for such credits arises, regardless of the year such additional qualified basis is determined. The additional qualified basis is determined by reference to the original adjusted basis (before deductions for depreciation) of the property.

The credit amount on the additional qualified basis is adjusted in the first year such additions are made using an averaging convention to reflect the number of months units comprising the additional qualified basis were occupied by low-income individuals during the year. Any reduction of the credit amount in the first year may not be claimed in a later year. (This first-year adjustment does not affect the amount of additional qualified basis with respect to which the credit is claimed in subsequent years of the compliance period.)

*Eligible basis*

Eligible basis consists of (1) the cost of new construction, (2) the cost of rehabilitation, or (3) the cost of acquisition of existing buildings acquired by purchase (including the cost of rehabilitation, if any, to such buildings incurred before the close of the first taxable year of the credit period which do not exceed a prescribed minimum amount). Only the adjusted basis of the depreciable property may be included in eligible basis.[7] The cost of land is not included in adjusted basis.

Generally, the eligible basis of a building is determined at the time the building is placed in service. For this purpose, rehabilitation expenditures (in excess of $2,000 per unit) are treated as placed in service at the close of the period for which rehabilitation expenditures are aggregated, not to exceed 24 months. In the case of rehabilitation expenditures incurred in connection with the acquisition of an existing building (and which do not exceed a prescribed minimum amount), the capital expenditures incurred through the end of the first year of the credit period may be included in eligible basis.

For purposes of the low-income housing credit, the term residential rental property generally has the same meaning as residential rental property within Code section 142(d).[8] Thus, residential rental property includes residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project. Eligible basis may include the cost of such facilities and amenities (e.g., stoves, refrigerators, air conditioning units, etc.) only if the included amenities are comparable to the cost of the amenities in the low-income units. Additionally, the allocable cost of tenant facilities, such as swimming pools, other recreational fa-

---

[7] The adjusted basis is determined by taking into account the adjustments described in section 1016 (other than paragraphs (2) and (3) of sec. 1016(a), relating to depreciation deductions), including, for example, the basis adjustment provided in section 48(q) for any rehabilitation credits allowed under section 38.

[8] See, however, the discussion below on single room occupancy housing as property eligible for the low-income housing credit.

cilities, and parking areas, may be included provided there is no separate fee for the use of these facilities and they are made available on a comparable basis to all tenants in the project. (*See generally*, Treas. Reg. sec. 1.103-8(b)(4)(iii).)

Except as described below, costs of the residential rental units in a building which are not low-income units may be included in eligible basis only if such units are not above the average quality standard of the low-income units. Similarly, rehabilitation expenditures may not be included in eligible basis if such expenditures improve any unit in the building beyond comparability with the low-income units. Units are of comparable quality if the construction or acquisition costs are comparable and if such units are provided in a similar proportion for both the low-income and other tenants. Congress intended that, at the election of the taxpayer, the cost of a unit which would otherwise be excluded from eligible basis may be included in eligible basis if (1) the excess cost of such unit over the average cost of the low-income units does not exceed 15 percent of the average cost of the low-income units and (2) the excess cost is excluded from eligible basis.[9]

Residential rental property may qualify for the credit even though a portion of the building in which the residential rental units are located is used for a commercial use. No portion of the cost of such nonresidential rental property included in a project may be included in eligible basis. Congress intended that the costs of such a mixed-use facility be allocated according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the nonresidential rental property and the residential rental units. (*See*, e.g., Prop. Treas. Reg. sec. 1.103-8(b)(4)(v).)

*Certain rehabilitation expenditures.*—The qualified basis attributable to rehabilitation expenditures, unless incurred in connection with the acquisition of an existing building, must equal at least $2,000 per low-income unit.[10] The $2,000 minimum is computed as an average based on all qualifying expenditures in the building, rather than on a unit-by-unit determination. Qualified basis is determined in the same fractional manner as for new construction or acquisition costs even if all rehabilitation expenditures are made only to low-income units. Rehabilitation expenditures may be included in eligible basis without a transfer of property. Rehabilitation expenditures may be aggregated only for such expenditures incurred during any 24-month period. Where rehabilitation is limited to a group of units, Treasury may provide regulations treating a group of units as a separate new building.

Where rehabilitation expenditures are paid or incurred by a person (or persons) and the taxpayer acquires the property attributable to such expenditures (or an interest therein) before such property is placed in service, the taxpayer will be treated as having paid or incurred the expenditures (*see* Treas. Reg. sec. 1.167(k)-1(b)(1) and (2)). The portion of the basis of the property not attributable to rehabilitation expenditures may not be included in the eli-

[9] A technical amendment may be needed so that the statute reflects this intent.

[10] See, below, in the case of rehabilitation expenditures incurred in connection with the acquisition of an existing building that do not exceed the $2,000 per unit minimium.

gible basis relating to the rehabilitated property, but may be includable in the eligible basis relating to acquisition costs, as described below.

*Acquisition of existing buildings.*—The cost of acquisition of an existing building may be included in eligible basis and any rehabilitation expenditures to such a building incurred before the close of the first year of the credit period may at the election of the taxpayer also be included in eligible basis, without a minimum rehabilitation requirement. These costs may be included in eligible basis, however, only if the building or a substantial improvement (a capital expenditure of 25 percent or more of the adjusted basis of the building to which five-year rapid amortization was elected or to which ACRS applied (as in effect before the enactment of this Act)) to the building has not been previously placed in service within 10 years and if the building (or rehabilitated property within the building) is not subject to the 15-year compliance period.

A building that is transferred in a transfer where the basis of the property in the hands of the new owner is determined in whole or part by the adjusted basis of the previous owner (for example, by a gift of property) is considered not to have been newly placed in service for purposes of the 10-year requirement.[11] Further, Congress intended that a building which has been acquired by a governmental unit or certain qualified 501(c)(3) or 501(c)(4) organizations would not be treated as placed in service by that governmental unit or organization for purposes of the 10-year requirement if the acquisition occurs more than 10 years from the date the building or a substantial improvement to the building has last been placed in service.[12] Congress also intended that a building acquired by foreclosure by taxpayers other than a governmental unit or 501(c)(3) organization would not be treated as newly placed in service by that taxpayer for purposes of the 10-year requirement if the foreclosure occurs more than 10 years from the date the building or a substantial improvement to the building has last been placed in service and the property is resold within a short period.[13] Any other transfer will begin a new 10-year period.

The Treasury Department may waive the 10-year requirement for any building substantially assisted, financed or operated under the HUD section 8, section 221(d)(3), or section 236 programs, or under the Farmers' Home Administration section 515 program when an assignment of the mortgage secured by property in the project to HUD or the Farmers Home Administration otherwise would occur or when a claim against a Federal mortgage insurance fund would occur.

*Federal grants and other subsidies.*—Eligible basis may not include in any taxable year the amount of any Federal grant, regardless of whether such grant is included in gross income. A Federal grant includes any grant funded in whole or in part by the Federal government, to the extent funded with Federal funds. Examples of grants which may not be included in eligible basis include grants

[11] Congress intended that inherited property not be treated as being newly placed in service for purposes of the 10-year requirement. A technical amendment may be needed so that the statute reflects this intent.

[12] A technical amendment may be needed so that the statute reflects this intent.

[13] A technical amendment may be needed so that the statute reflects this intent.

funded by Community Development Block Grants, Urban Development Action Grants, Rental Rehabilitation Grants, and Housing Development Grants.

If any portion of the eligible basis attributable to new construction or to rehabilitation expenditures is financed with Federal subsidies, the qualified basis is eligible only for the 30-percent present value credit, unless such Federal subsidies are excluded from eligible basis. A Federal subsidy is defined as any obligation the interest on which is exempt from tax under section 103 or a direct or indirect Federal loan, if the interest rate on such loan is less than the applicable Federal rate. A Federal loan under the Farmers' Home Administration section 515 program is an example of such a Federal subsidy, as is a reduced interest rate loan attributable in part to Federal grant funds lent to a building owner.

The determination of whether rehabilitation expenditures are federally subsidized is made without regard to the source of financing for the construction or acquisition of the building to which the rehabilitation expenditures are made. For example, a Federal loan or tax-exempt bond financing that is continued or assumed upon purchase of existing housing is disregarded for purposes of the credit on rehabilitation expenditures. Congress intended that tax-exempt financing or a below market loan to provide construction financing for any building will not be treated as a Federal subsidy if such loan is repaid and any underlying obligation (e.g., tax-exempt bond) is redeemed before the building is placed in service.[14]

### *Minimum set-aside requirement for low-income individuals*

#### *In general*

A residential rental project providing low-income housing qualifies for the credit only if (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 50 percent or less of area median income, as adjusted for family size, or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of area median income, as adjusted for family size.[15] (This requirement is referred to as the "minimum set-aside" requirement.)

A special set-aside may be elected for projects that satisfy a stricter requirement and that significantly restrict the rents on the low-income units relative to the other residential units in the building (the "deep-rent skewing" set-aside). Projects qualify for this rule only if, as part of the general set-aside requirement, 15 percent or more of all low-income units are occupied by individuals having incomes of 40 percent (rather than 50 percent or 60 percent) or less of area median income, and the average rent charged to tenants in the residential rental units which are not low-income units is at least 300 percent of the average rent charged to low-income tenants for comparable units. Under this special rule, a low-income

[14] A technical amendment may be needed so that the statute reflects this intent.

[15] A special set-aside requirement providing that 25 percent or more of the units are occupied by individuals with incomes of 60 percent or less of area median income is provided for New York City (see sec. 142(d)(6)).

tenant will continue to qualify as such, as long as the tenant's income does not exceed 170 percent of the qualifying income. Additionally, if a project to which this special set-aside requirement applies ceases to comply with the requirement because of increases in existing tenants' incomes, no penalties are imposed if each available low-income unit is rented to tenants having incomes of 40 percent or less of area median income, until the project is again in compliance.[16]

All units comprising the minimum set-aside in a project must be suitable for occupancy and used on a nontransient basis, and are subject to the limitation on gross rent charged to residents of set-aside units. (See the discussion of the gross rent limitation, below.)

The owner of each project must irrevocably elect the minimum set-aside requirement (including the deep-rent skewing set-aside described above) at the time the project is placed in service. In the case of a project consisting of a single building, the set-aside requirement must be met within 12 months of the date the building (or rehabilitated property) is placed in service, and complied with continuously thereafter for a period ending 15 years after the first day of the first taxable year in which the credit is claimed.

Special rules apply to projects consisting of multiple buildings placed in service on different dates. Unless prescribed by regulations, the initial building, within 12 months of being placed in service, must meet the set-aside requirement determined only by reference to those units in the initial building. When a second or subsequent building is placed in service, the project must meet the set-aside requirement with respect to the units in all buildings placed-in-service up to that time within 12 months of the date the second or subsequent building is placed in service.[17] The project must comply with this expanded requirement continuously thereafter for a period ending 15 years after the later of (1) the first day of the taxable year in which the expanded requirement is met or (2) if a credit is claimed with respect to the building, the first day of the taxable year in which the credit period begins with such building.[18] Subsequent buildings are subject to separate 15-year compliance periods. After the 15-year period has expired on an initial building, but while other buildings in the same project are still subject to the compliance period, the project must continue to meet the set-aside requirement determined by reference to all buildings in the project or, at the taxpayer's election, all buildings subject to the compliance period.

---

[16] Congress intended that for projects electing this stricter set-aside requirement the definition of gross rent is that used generally for purposes of the low-income credit. A technical amendment may be needed so that the statute reflects this intent.

[17] Congress intended that if within 12 months of the date a first building is placed in service, (1) the first building does not meet the set-aside requirement with respect to the first building and (2) a second building is placed in service, then the project is a qualified low-income project if the set-aside requirement is satisfied with respect to both buildings within 12 months of the placed-in-service date of the first building. A technical amendment may be needed so that the statute reflects this intent. Congress intended that similar rules apply by Treasury Department regulations in the case of projects with more than two buildings.

[18] Until the expanded requirement is met, the set-aside requirements determined by reference to all previously existing buildings must be continuously satisfied.