Continuous compliance required

The determination of whether a tenant qualifies for purposes of the low-income set-aside is made on a continuing basis, both with regard to the tenant's income and the qualifying area income, rather than only on the date the tenant initially occupies the unit. An increase in a tenant's income may result, therefore, in a unit ceasing to qualify as occupied by a low-income person. However, a qualified low-income tenant is treated as continuing to be such notwithstanding *de minimis* increases in his or her income. Under this rule, a tenant qualifying when initially occupying a rental unit will be treated as continuing to have such an income provided his or her income does not increase to a level more than 40 percent in excess of the maximum qualifying income, adjusted for family size. If the tenant's income increases to a level more than 40 percent above the otherwise applicable ceiling (or if the tenant's family size decreases so that a lower maximum family income applies to the tenant) that tenant is no longer counted in determining whether the project satisfies the set-aside requirement.[19] No penalty is assessed in such an event, however, provided that each residential rental unit that becomes vacant (of comparable or smaller size to the units no longer satisfying the applicable income requirement) is rented to tenants satisfying the qualifying income until the project is again in compliance. (For a discussion of the rules for complying with the set-aside requirements, see the discussion of the compliance period and penalty for noncompliance, below.)

Vacant units, formerly occupied by low-income individuals, may continue to be treated as occupied by a qualified low-income individual for purposes of the set-aside requirement (as well as for determining qualified basis) provided reasonable attempts are made to rent the unit and no other units of comparable or smaller size in the project are rented to nonqualifying individuals (see the section "Compliance period and penalty for noncompliance," below).

In no case is a unit considered to be occupied by low-income individuals if all of the occupants of such unit are students (as determined under sec. 151(c)(4)), no one of whom is entitled to file a joint income tax return.

Adjustments for family size

As stated above, the Act requires that adjustments for family size be made in determining the incomes used to qualify tenants as having low income. In general, these adjustments are the same as the adjustments presently made under section 8 of the United States Housing Act of 1937. Thus, for a project which qualifies by setting aside 20 percent of the units for tenants having incomes of 50 percent or less of area median income, a family of four generally will be treated as meeting this standard if the family has an income of 50 percent or less of the area median income; a family of three having an income of 45 percent or less generally will qualify; a family of two having an income of 40 percent or less generally

[19] In the case of projects electing the deep-rent skewing set-aside, a tenant's income may increase to 70 percent more than the maximum qualifying income.

will qualify; and, a single individual having an income of 35 percent or less generally will qualify.

Congress was aware that, in certain cases, the use of section 8 guidelines may result in qualifying incomes below the amounts reflected by these percentages because of dollar ceilings that are applied under the section 8 program. Income limits may be adjusted by the Treasury Department for areas with unusually low family income or high housing costs relative to family income in a manner consistent with determinations of very low income families and area median gross income under section 8 to reflect the 50-percent and 60-percent income levels.

Gross rent limitation

The gross rent paid by families in units included in qualified basis may not exceed 30 percent of the applicable qualifying income, adjusted for family size. Gross rent includes the cost of any utilities, other than telephone. If any utilities are paid directly by the tenant, the maximum rent that may be paid by the tenant is to be reduced by a utility allowance prescribed by the Treasury Department, after taking into consideration the procedures for making such adjustments under section 8 of the United States Housing Act of 1937.

The gross rent limitation applies only to payments made directly by the tenant. Any rental assistance payments made on behalf of the tenant, such as through section 8 of the United States Housing Act of 1937 or any comparable Federal rental assistance, are not included in gross rent. Congress further intended that any comparable State or local government rental assistance not be included in gross rent.[20]

Low-income unit

A low-income unit includes any unit in a qualified low-income building if the individuals occupying such unit meet the income limitation elected for the project for purposes of the minimum set-aside requirement and if the unit meets the gross rent requirement, as well as meeting all other requirements applicable to units satisfying the minimum set-aside requirement.

Qualified low-income housing projects and qualified low-income buildings

A qualified low-income building is a building subject to the 15-year compliance period and which is part of a qualified low-income housing project.

A qualified low-income housing project is a project that meets the minimum set-aside requirement and other requirements with respect to the set-aside units at all times that buildings comprising the project are subject to the 15-year compliance period. A qualified low-income housing project includes a qualified low-income building containing residential rental units and other property that is functionally related and subordinate to the function of providing

[20] A technical amendment may be needed so that the statute reflects this intent. Such an amendment was included in the versions of H. Con. Res. 395 which passed the House of Representatives and Senate in the 99th Congress.

residential rental units. A project may include multiple buildings having similarly constructed housing units, provided the buildings are located on the same tract of land, are owned by the same person for Federal income tax purposes, and are financed pursuant to a common plan of financing.

Residential rental units must be for use by the general public and all of the units in a project must be used on a nontransient basis. Residential rental units are not for use by the general public, for example, if the units are provided only for members of a social organization or provided by an employer for its employees. Generally, a unit is considered to be used on a nontransient basis if the initial lease term is six months or greater. Additionally, no hospital, nursing home, sanitarium, lifecare facility, retirement home providing significant services other than housing, dormitory, or trailer park may be a qualified low-income project. Factory-made housing which is permanently fixed to real property may be a qualified low-income building (see Treas. Reg. sec. 6a.103A-2(d)(4)(i) on factory-made housing).

Unlike the requirements for units in projects financed with tax-exempt bonds, certain single room occupancy housing used on a nontransient basis may qualify for the credit, even though such housing may provide eating, cooking, and sanitation facilities on a shared basis. An example of housing that may qualify for the credit is a residential hotel used on a nontransient basis that is available to all members of the public.

Compliance period and penalty for noncompliance

Qualified residential rental projects must remain as rental property and must satisfy the minimum set-aside requirement, described above, throughout a prescribed compliance period. Low-income units comprising the qualified basis on which additional credits are based are required to comply continuously with all requirements in the same manner as units satisfying the minimum set-aside requirement. Units in addition to those meeting the minimum set-aside requirement on which a credit is allowable also must continuously comply with this requirement.

The Act defines the compliance period for any building as the period beginning on the first day of the first taxable year of the credit period of such building and ending 15 years from such date. The minimum set-aside requirement must be met, in all cases, within 1 year of the date the building (or rehabilitated property) is placed in service.

Within 90 days of the end of the first taxable year for which the credit is claimed and annually for each taxable year thereafter during the compliance period, the taxpayer must certify to the Secretary that the project has continuously complied throughout the year with the set-aside requirement and report the dollar amount of the qualified basis of the building and the maximum applicable percentage and qualified basis permitted to be taken into account by the housing credit agency. Additionally, the certification must include the date (including the taxable year) in which the building was placed in service and any other information required by Treasury.[21]

The penalty for any building subject to the 15-year compliance period failing to remain part of a qualified low-income project (due, for example, to noncompliance with the minimum set-aside requirement or the gross rent requirement or other requirements with respect to the units comprising the set-aside) is recapture of the accelerated portion of the credit, with interest, for all prior years.

Generally, any change in ownership by a taxpayer of a building subject to the compliance period is also a recapture event. An exception is provided if the seller posts a bond with the Treasury Department (in an amount prescribed by Treasury) and provided it can reasonably be expected that such building will continue to be operated as a qualified low-income building for the remainder of the compliance period. For partnerships consisting of more than 35 individual taxpayers, at the partnership's election, no change in ownership will be deemed to occur provided within a 12-month period at least 50 percent (in value) of the original ownership is unchanged.[22]

In the year of a recapture event, no credit is allowable for the taxpayer subject to recapture. Additionally, the accelerated portion of credits paid in earlier years is recaptured with interest, from the date the recaptured amount was claimed, at the overpayment rate established under section 6621. The accelerated portion of the credit in any year is the amount of credits determined for the year, less the amount which would have been determined for the year if all credits had been allowed ratably over the 15-year compliance period (with no further discounting). Because credits on the initial qualified basis of a building are claimed ratably over a 10-year credit period rather than the 15-year compliance period, the amount of credit recaptured for noncompliance during the first 11 years is one-third of the credit determined for the year, plus interest. In the absence of additions to qualified basis and previous recapture events, the credits are recaptured in the following amounts (in addition to interest): one-third for violations after year 1 and before expiration of year 11; four-fifteenths for violations after year 11 but before expiration of year 12; three-fifteenths for violations after year 12 but before expiration of year 13; two-fifteenths for violations after year 13 but before expiration of year 14; and one-fifteenth for violations after year 14 but before expiration of year 15.

Because credits claimed on additions to qualified basis are paid ratably over the remainder of the compliance period (the credit percentage is two-thirds of the otherwise applicable percentage), there is no accelerated portion of credits attributable to additions to qualified basis and, therefore, no recapture of these amounts.

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[21] Congress intended that the penalty under sec. 6652(j) shall apply for failure to provide such information. A technical amendment may be needed so that the statute reflects this intent.

[22] Congress intended that the presence of corporate partners not disqualify the partnership from this special exception provided the partnership is at least 50 percent owned by at least 35 individual taxpayers. A technical amendment may be needed so that the statute reflects this intent.

The penalty for a decrease in the qualified basis of a building, while still remaining part of a qualified low-income project, is recapture of the credits with respect to the accelerated amount claimed for all previous years on the amount of the reduction in qualified basis.

Owners and operators of low-income housing projects on which a credit has been claimed must correct any noncompliance with the set-aside requirement or with a reduction in qualified basis within a reasonable period after the noncompliance is discovered or reasonably should have been discovered. If any noncompliance is corrected within a reasonable period, there is no recapture. Congress did not intend, however, that tenants be evicted to return a project to compliance. Rather, Congress intended that each residential rental unit of comparable or smaller size that becomes vacant while a project is not in compliance must be rented to a tenant having a qualifying income before any units in the project are rented to tenants not so qualifying until the project again is in compliance. In general, therefore, the event that gives rise to the penalty for noncompliance (i.e., recapture or a reduction in the allowable credit) will be rental of a unit to other than a low-income tenant (on other than a temporary basis) during any period when the project does not comply with the set-aside requirement or with the qualified basis amounts on which the credit is computed (or would not qualify as a result of that rental).

An example of how the recapture provisions operate follows:

Example.— Assume credits are claimed for a project based on a qualified basis of 30 percent of the basis of the project being allocable to units occupied by individuals with incomes of 50 percent or less of area median income and, at a later date, a qualified basis of only 25 percent of the basis of the project is allocable to units occupied by individuals with incomes of 50 percent or less of median income due to vacancies filled by tenants with nonqualifying incomes. Because the minimum set-aside requirement is not violated, recapture occurs only on the accelerated portion of the credit amounts allocable to the 5-percent basis of the project no longer eligible for the credit.

If the maximum credit for which a project is eligible increases and subsequently decreases, a last-in, first-out rule is applied in determining which credits are recaptured. For example, consider a building that initially claimed a credit based on a qualified basis of 25 percent of the basis of the building allocable to units occupied by individuals with incomes of 50 percent or less of area median income, and in year 3 began receiving a credit based on an additional 10 percent of the basis of the building (i.e., a total of 35 percent). The credit amount on the additions to qualified basis is computed by reference to two-thirds of the credit percentage. If in year 5 only 30 percent of the basis of the building qualifies, there is no recapture of previous years' credits because there is no accelerated portion of the credit amounts attributable to the 5 percent of the additions to qualified basis claimed since year 3.

Congress intended that there be no recapture for *de minimis* changes in the qualified basis by reason of changes in the floor space fraction.[23] A reduction in qualified basis by reason of a casualty loss is not a recapture event provided such property is restored by reconstruction or replacement within a reasonable period.

State low-income housing credit authority limitation

Generally, any building eligible for the credit must receive an allocation of credit authority from the State or local credit agency in whose jurisdiction the qualifying low-income housing project is located. (An exception is provided for buildings financed with the proceeds of tax-exempt bonds that received an allocation pursuant to the new private activity bond volume limitation.) The aggregate amount of such credits allocated within the State is limited by the State annual low-income credit authority limitation. In all cases, credit allocations are counted against a State's annual credit authority limitation for the calendar year in which the credits are allocated. Congress intended that credits may be allocated only during the calendar year in which the building or rehabilitated property is placed in service, except in the case of (1) credits claimed on additions to qualified basis and (2) credits allocated in a later year pursuant to an earlier binding commitment made no later than the year in which the building is placed in service.[24] Under this latter exception, for example, a building placed in service in 1987 may receive a binding commitment in 1987 to receive a credit allocation of a specified amount in 1989. In 1989 this amount is subtracted from the State credit authority limitation. The credit period and compliance period with respect to the building begin in the taxable year in which the building is placed in service or, by an irrevocable election of the taxpayer, the succeeding taxable year.

An election by the taxpayer to defer the start of the credit period for one year does not affect when the allocation must occur. (See also, the discussion below for credits claimed on additions to qualified basis). The credit amount allocated to a building applies for the year the allocation is made and for all future years of the compliance period.

Allowable credit authority

General rules.—The annual credit authority limitation for each State is equal to $1.25 for every individual who is a resident of the State (as determined by the most recent estimate of the State's population released by the Bureau of the Census before the beginning of the year to which the limitation applies). For purposes of the credit authority limitation, the District of Columbia and U.S. possessions (e.g., Puerto Rico, the Virgin Islands, Guam, and American Samoa) are treated as States.

Special set-aside for qualified nonprofit organizations.—A portion of each State's credit authority limitation is set aside for exclusive use by qualified nonprofit organizations. This set-aside is equal to $0.125 per resident of the State. This set-aside amount may not be changed by State action, either legislative or gubernatorial. In ad-

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

[24] A technical amendment may be needed so that the statute reflects this intent. Credits allocated pursuant to an earlier binding commitment are counted against the State's annual credit authority limitation in the calendar year of the allocation.

dition to the special set-aside, qualified nonprofit organization projects may be allocated any additional amount of a State's remaining credit authority.

To qualify for allocations from this set-aside, an organization must be a section 501(c)(3) or 501(c)(4) organization, one of the exempt purposes of which includes the fostering of low-income housing, and the qualifying project with respect to which the credits are allocated must be one in which such organization materially participates (within the meaning of the passive loss rule). Among the operations in which the organization must be involved in on a regular, continuous, and substantial basis, in addition to the continuing operation of the project, is the development of the project.

Credits subject to the credit authority limitation

Generally, credits subject to the State credit authority limitation include any credits attributable to expenditures not financed with tax-exempt bonds subject to the new private activity bond volume limitation.

In the case of a building financed with the proceeds of tax-exempt bonds subject to the bond volume limitation (Code sec. 146), if 70 percent or more of the aggregate basis of the building and land on which the building is located is financed with such proceeds, no portion of the credits attributable to such building is subject to the credit authority limitation.

If less than 70 percent of the aggregate basis of the building and land on which the building is located is financed with tax-exempt bonds subject to the bond volume limitation, only credits attributable to those bond-financed expenditures are not subject to the credit authority limitation.

Allocation of credit authority limitation among the State and other qualified governmental units therein

In general.—Each State's credit authority limitation is allocated among the various governmental units within the State pursuant to three alternative procedures.

Under the first procedure, each State's credit authority limitation is allocated in its entirety to the State housing agency until either the governor or the legislature makes a different allocation. If more than one such agency exists, they are treated as one agency. In the absence of a qualified State agency, no allocation may occur until provided by either the governor or the legislature.

Under the second procedure, the governor of each State is provided authority to allocate the State's credit authority limitation among all of the governmental units and other issuing authorities. This authority and any allocation rules established by the governor terminate as of the effective date of any overriding State legislation.

Under the third procedure, the State legislature may enact a law providing for a different allocation than that provided under the first or second procedures. Under this authority, the State legislature may allocate all or any portion of the State limitation to any governmental unit or other issuing authority in the State.