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.

Congress intended that any allocation procedure established by the governor or State legislature give balanced consideration to the low-income housing needs of the entire State.

Congress desired to clarify that gubernatorial proclamations issued before the date of enactment of the Act (October 22, 1986) or State legislation enacted before that date is recognized for purposes of allocating the credit authority limitations, provided that the proclamation or legislation refers to the low-income housing tax credit authority limitation.

Congress further intended that a State be permitted to allocate available credit authority to a local issuer until a specified date during each year (e.g., November 1) at which time the authority, if unused, may revert to the State for reallocation. Similarly, a State statute may provide discretionary authority to a public official (e.g., the governor) to allocate the State's credit authority limitation. Because the credit authority limitation is an annual amount, however, any authority that has not been used for credits issued before the end of the calendar year expires.

Special rule for constitutional home rule subdivisions.—The Act provides a special allocation rule for certain political subdivisions with home rule powers under a State constitution (Illinois). The home rule subdivisions to which the special allocation rule applies are those home rule subdivisions that are granted home rule powers by the beginning of the calendar year in which the credits are issued pursuant to a State constitution that was adopted in 1970 and became effective on July 1, 1971. In that State, a full portion of the State credit authority limitation is allocated to each home rule subdivision based upon the ratio that the population of that home rule subdivision bears to the population of the entire State. As is true of the other credit authority limitation determinations, this allocation is made using the most recent population estimate from the Bureau of the Census released before the beginning of the calendar year to which the credits relate. The amount so allocated to home rule subdivisions may not be altered by the power to provide a different allocation otherwise granted by the Act to the governor or the State legislature. However, a home rule subdivision may agree to a different allocation.

The portion of a State's credit authority limitation not allocated to constitutional home rule subdivisions then is allocated under essentially the same three procedures described in the previous section. Thus, under the first procedure, the remaining State credit authority limitation is allocated to the State housing agency. Under the second and third procedures described above, the governor or the State legislature may allocate the State limitation other than that allocated to home rule subdivisions to any governmental units (including home rule subdivisions).

For purposes of the rules on State action establishing allocation rules for the credit authority limitation, a mayor of a constitutional home rule subdivision is treated as a governor, and a city council is treated as a State legislature.

Constitutional home rule subdivisions are treated as States for purposes of the credit authority limitation set-aside for qualified nonprofit organizations. Pursuant to their general authority to alter credit allocation, described above, these subdivisions may agree with the State in which they are located to exchange authority to allocate credits for qualified nonprofit organizations for authority to allocate credits for other projects.

Allocation of set-aside amount for qualified nonprofit organizations.—As described above, a portion of each State's credit authority limitation is set aside exclusively for projects of qualified nonprofit organizations. Although the overall amount of credit authority set aside for these credits may not be reduced by any State action, a State may enact a statute determining which credit authorities in the State may allocate these credits and may allocate the entire set-aside amount to those authorities. Similarly, before any legislation, a governor may determine which authorities may allocate credits under the set-aside. The amount of the remaining credit authority limitation allocated to all other authorities must, of course, be adjusted to take into account any reallocation of the set-aside amount.

Determination of credit amount allocation

A building must receive low-income credit authority from the credit agency in whose jurisdiction the qualifying low-income building is located. The credit agency's remaining authority is reduced by the credit percentage multiplied by the amount of qualified basis granted by the credit agency for the building. The credit agency may grant a smaller credit percentage and a smaller qualified basis amount at the time the allocation is made than the maximum percentage and amount that would otherwise be allowed. Congress intended that the credit agencies reduce the maximum available credit percentage when the financing and rental assistance for a project from all sources is sufficient to provide the continuing operation of the qualifying low-income building without the maximum credit.

A credit agency's credit authority is reduced by the maximum amount of credit granted, whether or not the property ultimately is eligible for this maximum amount, and without regard to the averaging convention used in the first year of the credit period.

If a building is granted more credits than would be claimed in the first year of the credit period, without regard to the averaging convention, such amounts are not restored to the credit agency's authority. Such amounts may, however, be used in a later year by the owner of the building to the extent the credit determined with respect to the building is increased as a result of additions to qualified basis (but not beyond the amount allocated by the agency, and without regard to the reduced percentage applicable to such additions). (See also, the discussion on additions to qualified basis, above.)

Example 1.—Assume in calendar year 1987 a newly constructed building is placed in service and that the building's qualified basis, before consideration of the credit authority limitation, is determined to be $100,000 in that year. The credit agency may allocate any amount of qualified basis to the building, but the taxpayer may treat as his qualified basis only the lesser of (1) the qualified basis of the building, before consideration of the credit authority limitation, or (2) the qualified basis allocated to the building by the credit agency. If the credit agency allocated $100,000 of qualified basis and the maximum 9 percent credit percentage to the building, the agency's remaining 1987 credit authority would be reduced by $9,000.

Example 2.—Assume $120,000 in qualified basis and a credit percentage of 9 percent were initially authorized by a credit agency in 1987 for a qualified low-income building and that in 1987, the first year of the credit period, the building's qualified basis was $100,000. The credit agency's remaining 1987 credit authority is reduced by $10,800. If in year two of the credit period the qualified basis of the building increases by up to $20,000 due to an increase in the number of low-income units, additional credits may be claimed with respect to this addition to qualified basis without requiring additional credit authority from the credit agency. The credit percentage applicable to the additional qualified basis is two-thirds of the credit percentage applicable to the initial qualified basis. Credits on the additions to qualified basis may be claimed over the remainder of the compliance period.

If the qualified basis of a building is greater than the qualified basis allocated to it by the credit agency, credits may not be claimed on the excess portion unless additional low-income housing credits are allocated to the building by the credit agency. The credit authority of the credit agency is reduced for the calendar year of any such additional allocations.

Generally, no carryover authority for unused credit authority is permitted. A limited exception is provided for buildings placed in service in 1990, if expenditures of 10 percent or more of total project costs are incurred before January 1, 1989. Credit authority for such property may be carried over from the 1989 credit allocation for the credit agency. Congress intended that, for allocations made after 1987, if a building cannot be placed in service in the year for which the allocation was made for reasons beyond the control of the taxpayer, then upon approval by the Treasury Department, the credit allocation will be valid if the building is placed in service in the succeeding year.[25]

Credit agencies are permitted to enter into binding commitments to allocate future credit authority for years before the sunset date to buildings not yet placed in service by binding contracts or other means.

Should a credit agency issue more credits than its credit authority limitation provides, credits will be denied to those buildings last allocated credits until the credit authority limitation is not exceeded.

Credit administration

Credit agencies allocating credits may not condition allocation of credits to the source of financing for the qualifying low-income building. The Act authorizes the Treasury Department to prescribe regulations that may require credit recipients to pay a reasonable fee to cover administrative expenses of the credit agency. The fact that credits must be allocated on a building-by-building basis does not preclude a credit agency from charging a single fee for process-

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

ing credits for a single project with multiple buildings or for multiple projects of a common taxpayer.

Agencies allocating credits must file reports with the Treasury Department containing (1) the maximum applicable percentage and qualified basis of each building, (2) the fees, if any, charged to credit recipients, (3) the aggregate amount of credits issued, and (4) other information required by Treasury. The time and manner of filing such reports and other information required are to be specified by the Treasury Department.

Transferability

A new owner of a building during its 15-year compliance period is eligible to continue to receive the credit as if the new owner were the original owner, using the same qualified basis and credit percentages as used by the original owner. Rehabilitation expenditures on such property may qualify for a credit in the same manner as rehabilitation expenditures on other qualifying property. The accelerated portion of credits claimed in previous years will be recaptured upon a transfer, subject to the election of the original owner to post a bond. All dispositions of ownership interests in buildings are treated as transfers for purposes of recapture, except for a special rule for certain partnerships. (There is no election for the new owner to assume the recapture liability for prior year credits.)

At-risk limitation

Property with respect to which a low-income housing tax credit is claimed is subject to an at-risk limitation similar to the investment tax credit at-risk rules in the case of nonqualified nonrecourse financing. An exception is provided for lenders related to the buyer of the low-income housing property. Another exception provides that the general investment tax credit at-risk rule, limiting the amount of nonrecourse financing to 80 percent of the credit base of the property, does not apply in the case of the low-income housing tax credit.[26]

A further exception is provided for financing (including seller financing) not in excess of 60 percent of the basis of the property that is lent by 501(c)(3) and 501(c)(4) organizations whose exempt purpose includes fostering low-income housing. Further, if the rate of interest for any financing qualifying for this exception is below the applicable Federal rate at the time the financing is incurred, less 1 percentage point, then the qualified basis to which such financing relates shall be reduced to reflect the present value of the payments of principal and interest, using as the discount rate such applicable Federal rate. The credit is recaptured if the financing provided by such organizations is not repaid with interest by the end of the 15-year credit compliance period.

Coordination with other provisions

The credit is subject to the rules of the general business credit, including the maximum amount of income tax liability that may

[26] This exception was enacted in the Omnibus Budget Reconciliation Act of 1986, P.L. 99-509.

be reduced by a general business tax credit in any year. Unused credits for any taxable year may be carried back to each of the 3 preceding taxable years and then carried forward to each of the 15 following taxable years. Congress intended that no credits be carried back to taxable years ending prior to January 1, 1987.[27]

For purposes of the rules in the Act limiting passive loss deductions, the credit (but not losses) is treated as arising from rental real estate activities in which the taxpayer actively participates. Credits may be used to offset tax on up to $25,000 of nonpassive income, subject to a phaseout between $200,000 and $250,000 of adjusted gross income (disregarding passive losses).

The basis of property for purposes of depreciation is not reduced by the amount of low-income credits claimed.

Effective Date

The credit is effective for buildings placed in service after December 31, 1986, and before January 1, 1991, other than (1) property to which the depreciation rules of prior-law apply or (2) property with respect to which any investor is eligible for passive losses under the special transitional exception contained in section 502 of the Act. Congress further intended that no property to which the provision of prior law allowing five-year amortization of rehabilitation expenditures applies may be included in eligible basis.[28] As stated above, all buildings eligible for the credit must be placed in service before January 1, 1991.[29] A building placed in service in 1990 is eligible for the credit, however, only if expenditures of 10 percent or more of the reasonably expected cost of the building are incurred before January 1, 1989. Under a special rule, described above, credit authority for such property placed in service in 1990 may be carried over from the 1989 volume allocation for any credit agency.

Revenue Effect

The low-income rental housing tax credit is estimated to reduce fiscal year budget receipts by $67 million in 1987, $324 million in 1988, $705 million in 1989, $1,011 million in 1990, and $1,139 million in 1991.

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

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

[29] The Act contains a general rule preventing the allocation of credit authority to buildings placed in service after 1990. Congress intended that tax-exempt bond-financed projects be treated in the same manner as other projects, and are not eligible for the credit if placed in service after 1990. 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.