

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[T.D. 8430]

RIN 1545-AQ07

**Procedure for Monitoring Compliance
With Low-Income Housing Credit
Requirements; Correction**

AGENCY: Internal Revenue Service.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to Treasury Decision 8430, which was published in the Federal Register for Wednesday, September 2, 1992 (57 FR 40118). The final regulations relate to the requirement that State allocation plans provide a procedure for State and local housing credit agencies to monitor for compliance with the requirements of section 42 of the Internal Revenue Code.
EFFECTIVE DATE: June 30, 1993.

FOR FURTHER INFORMATION CONTACT:

Paul F. Handleman, (202) 622-3040 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections provide rules under section 42 of the Internal Revenue Code requiring State and local housing credit agencies to report any noncompliance to the Internal Revenue Service.

Need for Correction

As published, T.D. 8430 contains errors which may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 8430), which was the subject of FR Doc. 92-21156, is corrected as follows:

1. On page 40122, column 2, § 1.42-5(c)(2)(i), line 1, the language "(i) require that the Agency review the" is corrected to read "(i) Require that the Agency review the".
2. On page 40122, column 2, § 1.42-5(c)(2)(ii), line 1 the language "(ii) contain at least one of the" is corrected to read "(ii) Contain at least one of the".

Cynthia E. Grigsby,

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Assistant Chief Counsel (Corporate).*

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[T.D. 8430]

RIN 1545-0007

**Procedure for Monitoring Compliance
With Low-income Housing Credit
Requirements****Correction**

In rule document 92-21156 beginning on page 40118 in the issue of Wednesday, September 2, 1992, make the following corrections:

§ 1.42-5 [Corrected]

1. On page 40122, in the second column, in § 1.42-5(c)(1)(vii), in the third line, "43(d)" should read "42(d)".
2. On the same page, in the third column, in § 1.42-5(c)(3), in the fourth line, "(c)(2) and (2)" should read "(c)(1) and (2)".
3. On page 40123, in the 2d column, in § 1.42-5(e)(2), in the 11th line, "(c)(2)(ii)(A),(B) or (c)" should read "(c)(2)(ii)(A),(B) or (C)".
4. On the same page, in the third column, in § 1.42-5(f)(1)(ii), in the sixth line, "preforms" should read "performs".

BILLING CODE 1565-01-0

Paperwork Reduction Act

The collection of information contained in this final regulation has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3504(h)) under control number 1545-1291. The estimated annual burden per State or local government respondent/recordkeeper varies from 10 hours to 1,500 hours, with an estimated average of 250 hours. The estimated annual burden for all other respondent/recordkeepers varies from .5 hours to 3 hours, with an estimated average of 1 hour.

These estimates are an approximation of the average time expected to be necessary for the collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

Comments concerning the accuracy of this burden and suggestions for reducing this burden should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Background

On December 27, 1991, the Internal Revenue Service published in the Federal Register a notice of proposed rulemaking (56 FR 67018) under section 42 of the Internal Revenue Code of 1986 with respect to the low-income housing credit.

A number of public comments were received concerning these regulations, and a public hearing was held on March 4, 1992. After consideration of the written comments and those presented at the hearing, the proposed regulations are adopted, as revised, by this Treasury decision.

Explanation of Provisions

Section 42 provides for a low-income housing credit that may be claimed as part of the general business credit under section 38. The credit determined under section 42 is allowable only to the extent the owner of a qualified low-income building receives a housing credit allocation from a State or local housing credit agency ("Agency"), unless the building is exempt from the allocation requirement by reason of section 42(h)(4)(B). Under section

42(m)(1)(A), the housing credit dollar amount for any building is zero unless the amount was allocated pursuant to a qualified allocation plan of the Agency. Similarly, under section 42(m)(1)(D), the housing credit dollar amount for any project qualifying under section 42(h)(4) is zero unless the project satisfies the requirements for allocation of a housing credit dollar amount under the qualified allocation plan of the Agency.

Under section 42(m)(1)(B)(iii), which was amended and renumbered by the Revenue Reconciliation Act of 1990 (the "1990 Act"), an allocation plan is not qualified unless it contains a procedure that the Agency (or an agent of, or private contractor hired by, the Agency) will follow in monitoring compliance with the provisions of section 42. The Agency is to notify the Internal Revenue Service of any noncompliance of which the Agency becomes aware.

Section 42(m)(1)(B)(iii) is effective on January 1, 1992, and applies to all buildings for which the low-income housing credit determined under section 42 is, or has been, allowable at any time.

These final regulations provide guidance on section 42(m)(1)(B)(iii). Under the regulations, an allocation plan meets the requirement of section 42(m)(1)(B)(iii) if it includes a monitoring procedure that contains, in substance, all of the provisions specified in the regulations.

The specified provisions are minimum requirements; a monitoring procedure may contain additional provisions or requirements. Moreover, the language, form, and order of the specified provisions as set forth in the regulations need not be exactly duplicated in an allocation plan in order for the plan to include a monitoring procedure as required by the regulations. As long as the substance of the provisions specified in the regulations is contained in the allocation plan as a whole, the allocation plan satisfies the monitoring procedure required by the regulations.

These regulations only address compliance monitoring procedures of Agencies. They do not address forms and other records that may be required by the Internal Revenue Service on examination or audit.

Public Comments*Comments on Recordkeeping and Record Retention*

One comment suggested that where an allocation of credit has been made on a project basis under section 42(h)(1)(F), the recordkeeping and record retention provisions should also apply on a project basis. This suggestion has not

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

(T.D. 8430)

RIN 1545-AD07

Procedure for Monitoring Compliance With Low-Income Housing Credit Requirements

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations relating to the requirement that State allocation plans provide a procedure for State and local housing credit agencies to monitor for compliance with the requirements of section 42 of the Internal Revenue Code. State and local housing credit agencies are to report any noncompliance to the Internal Revenue Service. These final regulations affect State and local housing credit agencies, owners of buildings or projects for which the low-income housing credit is claimed, and taxpayers claiming the low-income housing credit.

EFFECTIVE DATE: These final regulations are effective June 30, 1993.

FOR FURTHER INFORMATION CONTACT: Paul F. Handieman, (202) 622-3040 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

ps-78-9)

been adopted because only the minimum set-aside requirement under section 42(g)(1) is satisfied on a project-by-project basis. All other requirements of section 42 must be met on a building-by-building basis.

Two comments suggested that owners of low-income housing projects be required to keep records describing how utility allowances are determined. Because utility allowances are taken into account in determining whether a unit is rent-restricted under section 42(g)(2)(B)(ii), the final regulations include utility allowances among the rent records to be retained by owners.

Another comment suggested that owners should be required to keep records showing: (1) The number of occupants in each unit and changes in the number of occupants for those units where rent is determined by the number of occupants per unit; (2) information on unit size, including the number of bedrooms and square footage of the unit; and (3) how the eligible basis was calculated at the end of the first year of the credit period. These suggestions have been adopted by the final regulations. Also in response to this comment, the final regulations clarify that the records of tenant income should be kept on a per unit basis. However, this comment's suggestion that owners be required to retain marketing and advertising materials demonstrating that units are available to the general public has not been adopted by the final regulations because marketing and advertising materials may not be sufficient to demonstrate that a building satisfies the general public use requirement.

One comment suggested that if a building is sold or transferred, the building owner should be required to transfer all records to the new owner. In the case of an audit, the new owner needs at least some of those records in order to demonstrate that any credit is allowable for the building and to avoid recapture. In particular, records of the first year of the credit period are necessary to show that credit is allowable for any later year in the credit period. The final regulations do not address transfers of records to new owners of buildings because these regulations are directed to Agencies and Agencies are not required to monitor prior years of the compliance period once those years end. Nevertheless, even without an Agency requirement, the transferee, as part of its transaction with the transferor, should obtain the first year information from the transferor in order to substantiate credits claimed.

Several comments suggested that tenant participation in a housing assistance program under section 8 of the United States Housing Act of 1937 ("Section 8") should exempt the owner from having to obtain supporting income documentation from that tenant because public housing authorities verify each Section 8 tenant's income and assets. Participation in the Section 8 program does not necessarily guarantee that a tenant has a qualifying income equal to or less than the income limitation under section 42(g). However, in response to this suggestion, the final regulations provide that if public housing authorities submit a statement to the building owner declaring that a Section 8 tenant's income does not exceed the applicable income limit under section 42(g), the owner is not required to obtain other documentation to verify that tenant's income.

Several comments noted that the definition of annual income under the Section 8 program is based on the tenant's anticipated annual income for the 12 months following the income certification. These commentators suggested that federal income tax returns not be considered permissible documentation of income because tax returns only show income for the prior tax year. This suggestion has not been adopted by the final regulations because, although the determination of annual income is not based upon gross income for federal income tax purposes (tenant income is calculated in a manner consistent with the determination of annual income under Section 8), tax returns do supply evidence of a tenant's sources of income and are signed under penalty of perjury.

Several comments stated that the requirement that owners retain each year's records for 6 years beyond the end of the building's compliance period is unreasonable. In response to these comments, the final regulations do not require owners to retain a year's records for more than 6 years after the due date (with extensions) for filing the federal income tax return for that year. However, because under the final regulations the records for the first year of the credit period are needed to prove the building's eligibility for the credit each year, those records must be retained for at least 6 years beyond the due date (with extensions) for filing the federal income tax return for the last year of the building's compliance period. This is appropriate because, as noted above, these records may be needed to show that credit is allowable.

Two comments questioned whether records should be kept for the extended

use period under section 42(h)(6)(D). The final regulations do not contain any such requirement because recapture of the credit can result only from noncompliance occurring during the compliance period. However, an Agency may require retention of records for a longer period if it desires.

One comment questioned the period for which an Agency should retain its records. In response, the final regulations provide that an Agency must retain records of noncompliance or failure to certify for 6 years beyond the Agency's filing of the respective Form 8623, "Low-Income Housing Credit Agencies Report of Noncompliance." In all other cases, the Agency must retain the certifications and records for 3 years from the end of the calendar year the Agency receives the certifications and records.

Comments on Certification and Review

Two comments suggested that building owners be required to certify the applicable fraction and eligible basis claimed on the last filed Form 8609 (Schedule A), "Annual Statement." This suggestion has not been adopted because this information is already available to the Examination Division of the Internal Revenue Service. The Service bears the responsibility for determining whether a building owner has claimed the correct amount of credit each year and whether the building owner is subject to recapture. It is not the intent of these regulations to have Agencies audit income tax returns. However, in response to this comment, the final regulations add to the list of certifications a requirement that owners certify that the applicable fraction under section 42(c)(1)(B) has not changed from the prior year or, if the applicable fraction has changed, that the owners describe the change.

Several comments questioned whether an Agency is required to choose the reporting period the certifications cover or whether the certifications must cover the owner's taxable year. Those comments also suggested that the certifications should cover the preceding 12-month period. In response to this suggestion, the final regulations state that the annual owner certifications should cover the preceding 12-month period. However, an Agency is free to require more frequent certifications covering shorter time periods provided that all months within each 12-month period are subject to certification.

One comment suggested that the review provision should include monitoring for violations of the rent

restrictions under section 42(g)(2). This suggestion has been adopted by the final regulations.

Another comment suggested that the final regulations provide that the "next available unit" rule is not violated, and credit is not recaptured, if a vacant low-income unit of comparable or smaller size is rented on a temporary basis to a market-rate tenant. This suggestion has not been adopted. The issue of whether temporary rentals result in recapture of the credit is not properly addressed in regulations on compliance monitoring, but will be addressed in future guidance on credit recapture.

Two comments suggested that owners of buildings with 100 percent low-income occupancy should be required to submit tenant income certifications only for those units that became vacant after the previous year's compliance certifications were submitted. This suggestion has not been adopted because 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. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. 11-93 (1986), 1985-3 (Vol. 4) C.B. 93.

Numerous comments suggested that the review provision be revised to provide for random sampling in both review choices. In addition, the comments requested guidance as to the number of projects that must be inspected each year and the number of units in each project that must be examined. The comments also requested additional flexibility in designing a review procedure than that available under the proposed regulations. In response to these suggestions, the review provision of the final regulations has been revised to provide Agencies with more flexibility and certainty in designing monitoring procedures. The final regulations permit a review provision containing any one or more of the following three sets of requirements: (1) The owners of at least 50 percent of all low-income housing projects in the Agency's jurisdiction must submit to the Agency for compliance review a copy of the annual income certification, the documentation the owner has received to support that certification, and the rent record for each low-income tenant in at least 20 percent of the low-income units in their projects; (2) the Agency must inspect at least 20 percent of the low-income housing projects in the Agency's jurisdiction each year and must inspect the low-income certification, the documentation the owner has received

to support that certification, and the rent record for each low-income tenant in at least 20 percent of the low-income units in those projects; or (3) the owners of all low-income housing projects in the Agency's jurisdiction must submit to the Agency each year information on tenant income and rent for each low-income unit, in the form and manner designated by the Agency, and the owners of at least 20 percent of the projects in the Agency's jurisdiction must submit to the Agency for compliance review a copy of the annual income certification, the documentation the owner has received to support that certification, and the rent record for each low-income tenant in at least 20 percent of the low-income units in their projects. The Agency should determine which tenants' records are to be submitted by the owners for review.

Numerous comments questioned how the permitted exception would operate with respect to certain buildings financed with tax-exempt bond proceeds or with loans made under the Farmers Home Administration (FmHA) section 515 program. In response to these comments, the final regulations clarify this exception. Under the final regulations, a monitoring procedure may except FmHA-financed or bond-financed buildings from the review provision if the FmHA or tax-exempt bond issuer agrees to provide information concerning the income and rent of the tenants in the building to the Agency. The Agency may assume the accuracy of the information provided by the FmHA or the tax-exempt bond issuer without verification. The Agency must review the information and determine that the income limitation and rent restriction of section 42(g)(1) and (2) are met. However, if the information provided by the FmHA or tax-exempt bond issuer is not sufficient for the Agency to make this determination, the Agency must request the necessary additional income or rent information from the owner of the buildings.

Comments on Auditing

One comment suggested that the use of the term "auditing" in the proposed regulations is misleading because it implies that the Agency is to audit the tax records of the owner of the building for the Service. In response to this suggestion, the final regulations substitute the term "inspection."

Another comment noted that the proposed regulations could be interpreted as prohibiting a separate physical inspection of a building without a review of the records. This interpretation was not intended. An inspection may include, but is not required to include, a review of records.

Comments on Notification of Noncompliance

Several comments suggested that notification of noncompliance to the Service not be required where the noncompliance has been corrected within a reasonable amount of time. This suggestion has not been adopted because it may not always be easy or even possible for an Agency to determine whether corrected noncompliance results in recapture of the credit. Accordingly, under the final regulations, all noncompliance, whether or not corrected, must be reported so that the Service can determine whether the taxpayer is subject to recapture of the credit.

Another comment suggested that any change in a building's eligible basis should be considered noncompliance that must be reported to the Service. The commentator reasons that this is necessary to ensure that the information being provided on the annual certifications and Form 8588, "Low-Income Housing Credit," and Form 8609 (Schedule A) are consistent. Changes in eligible basis and the applicable fraction that result in a decrease in qualified basis result in recapture of credit. Therefore, the final regulations provide that any change in either the applicable fraction or eligible basis that results in a decrease in the project's qualified basis should be considered noncompliance that must be reported to the Service.

One comment suggested that tenant fraud should be reported to the Service. No specific changes to the regulations have been made in response to this suggestion. If tenant fraud results in noncompliance, the noncompliance should be reported.

Comments suggested that any notice sent to a building owner and the Form 8623 sent to the Service should be required to be sent by certified mail. These suggestions have not been adopted; although an Agency is free to use certified mail, it is not required to do so.

One comment suggested that any fees paid to an agent or other private contractor for delegated compliance monitoring should not be contingent upon a finding of compliance or noncompliance. The final regulations do not contain this suggested provision. However, it is the view of the Treasury and the Service that if an Agency makes the payment of compliance monitoring fees to an agent or private contractor contingent upon a finding of compliance or noncompliance, the Agency may not be using reasonable diligence to ensure that the agent or private contractor

properly performs the delegated compliance monitoring responsibilities.

One comment suggested that an Agency be permitted to delegate monitoring responsibilities to another Agency, including the responsibility of notifying the Service of any noncompliance of which the delegated Agency becomes aware. In response to this suggestion, the final regulations allow Agencies to delegate some or all of their compliance monitoring responsibilities for a building to another Agency within the State.

One comment suggested that although compliance monitoring is not required of Agencies before January 1, 1992, if an Agency becomes aware of noncompliance that occurred before that date, the Agency should be required to notify the Service of that noncompliance. The final regulations adopt this comment which reflects section 42(m)(1)(B)(iii) as effective before its amendment by the 1990 Act.

Several comments suggested that the regulations should expressly permit an Agency to establish reasonable administrative fees for covering an Agency's expenses in monitoring compliance, and other comments suggested that the failure to pay monitoring fees should be considered noncompliance. Section 42 does not prohibit an Agency from charging an administrative fee to cover the Agency's expenses in monitoring for compliance, but this is a matter for the determination of the Agency, rather than the Service. Accordingly, the regulations do not address any issues concerning Agency fees.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553 (b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805 (f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Paul F. Handelman, Office of the Assistant Chief Counsel (Pass-throughs and Special Industries), Internal Revenue Service. However,

other personnel from the Service and the Treasury Department participated in their development.

List of Subjects

26 CFR 1.57-1 through 1.44A-4

Credits, Income taxes, Reporting and Recordkeeping requirements.

26 CFR part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority citation for part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7005 * * * Section 1.42-5 is also issued under 26 U.S.C. 42 (n).

Par. 2. New § 1.42-5 is added to read as follows:

§ 1.42-5 Monitoring compliance with low-income housing credit requirements.

(a) *Compliance monitoring requirement*—(1) *In general.* Under section 42(m)(1)(B)(iii), an allocation plan is not qualified unless it contains a procedure that the State or local housing credit agency ("Agency") (or an agent of, or other private contractor hired by, the Agency) will follow in monitoring for noncompliance with the provisions of section 42 and in notifying the Internal Revenue Service of any noncompliance of which the Agency becomes aware. These regulations only address compliance monitoring procedures required of Agencies. The regulations do not address forms and other records that may be required by the Service on examination or audit. For example, if a building is sold or otherwise transferred by the owner, the transferee should obtain from the transferor information related to the first year of the credit period so that the transferee can substantiate credits claimed.

(2) *Requirements for a monitoring procedure*—(i) *In general.* A procedure for monitoring for noncompliance under section 42(m)(1)(B)(iii) must include—

(A) The recordkeeping and record retention provisions of paragraph (b) of this section;

(B) The certification and review provisions of paragraph (c) of this section;

(C) The inspection provision of paragraph (d) of this section; and

(D) The notification-of-noncompliance provisions of paragraph (e) of this section.

(ii) *Order and form.* A monitoring procedure will meet the requirements of section 42 (m)(1)(B)(iii) if it contains the substance of these provisions. The particular order and form of the provisions in the allocation plan is not material. A monitoring procedure may contain additional provisions or requirements.

(b) *Recordkeeping and record retention provisions*—(1) *Recordkeeping provision.* Under the recordkeeping provision, the owner of a low-income housing project must be required to keep records for each qualified low-income building in the project that show for each year in the compliance period—

(i) The total number of residential rental units in the building (including the number of bedrooms and the size in square feet of each residential rental unit);

(ii) The percentage of residential rental units in the building that are low-income units;

(iii) The rent charged on each residential rental unit in the building (including any utility allowances);

(iv) The number of occupants in each low-income unit, but only if rent is determined by the number of occupants in each unit under section 42(g)(2) (as in effect before the amendments made by the Revenue Reconciliation Act of 1989);

(v) The low-income unit vacancies in the building and information that shows when, and to whom, the next available units were rented;

(vi) The annual income certification of each low-income tenant per unit;

(vii) Documentation to support each low-income tenant's income certification (for example, a copy of the tenant's federal income tax return, Forms W-2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation). Tenant income is calculated in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937 ("Section 8"), not in accordance with the determination of gross income for federal income tax liability. In the case of a tenant receiving housing assistance payments under Section 8, the documentation requirement of this paragraph (b)(1)(vii) is satisfied if the public housing authority provides a statement to the building owner declaring that the tenant's income does not exceed the applicable income limit under section 42 (g).

(vii) The eligible basis and qualified basis of the building at the end of the first year of the credit period; and

(ix) The character and use of the nonresidential portion of the building included in the building's eligible basis under section 42(d) (e.g., tenant facilities that are available on a comparable basis to all tenants and for which no separate fee is charged for use of the facilities, or facilities reasonably required by the project).

(2) *Record retention provision.* Under the record retention provision, the owner of a low-income housing project must be required to retain the records described in paragraph (b)(1) of this section for at least 6 years after the due date (with extensions) for filing the federal income tax return for that year. The records for the first year of the credit period, however, must be retained for at least 8 years beyond the due date (with extensions) for filing the federal income tax return for the last year of the compliance period of the building.

(c) *Certification and review provisions—(1) Certification.* Under the certification provision, the owner of a low-income housing project must be required to certify at least annually to the Agency that, for the preceding 12-month period—

(i) The project met the requirements of:

(A) The 25-50 test under section 42(g)(1)(A), the 40-60 test under section 42(g)(1)(B), or the 25-60 test under sections 42(g)(4) and 142(d)(5) for New York City, whichever minimum set-aside test was applicable to the project; and

(B) If applicable to the project, the 15-40 test under sections 42(g)(4) and 142(d)(4)(B) for "deep rent skewed" projects;

(ii) There was no change in the applicable fraction (as defined in section 42(c)(1)(B)) of any building in the project, or that there was a change, and a description of the change;

(iii) The owner has received an annual income certification from each low-income tenant, and documentation to support that certification; or, in the case of a tenant receiving Section 8 housing assistance payments, the statement from a public housing authority described in paragraph (b)(1)(vii) of this section;

(iv) Each low-income unit in the project was rent-restricted under section 42(g)(2);

(v) All units in the project were for use by the general public and used on a nontransient basis (except for transitional housing for the homeless provided under section 42(i)(3)(B)(iii));

(vi) Each building in the project was suitable for occupancy, taking into

account local health, safety, and building codes;

(vii) There was no change in the eligible basis (as defined in section 43(d)) of any building in the project, or if there was a change, the nature of the change (e.g., a common area has become commercial space, or a fee is now charged for a tenant facility formerly provided without charge);

(viii) All tenant facilities included in the eligible basis under section 42(d) of any building in the project, such as swimming pools, other recreational facilities, and parking areas, were provided on a comparable basis without charge to all tenants in the building;

(ix) If a low-income unit in the project became vacant during the year, that reasonable attempts were or are being made to rent that unit or the next available unit of comparable or smaller size to tenants having a qualifying income before any units in the project were or will be rented to tenants not having a qualifying income;

(x) If the income of tenants of a low-income unit in the project increased above the limit allowed in section 42(g)(2)(D)(ii), the next available unit of comparable or smaller size in the project was or will be rented to tenants having a qualifying income; and

(xi) An extended low-income housing commitment as described in section 42(b)(6) was in effect (for buildings subject to section 7108(c)(1) of the Revenue Reconciliation Act of 1989).

(2) *Review.* The review provision must—

(i) require that the Agency review the certifications submitted under paragraph (c)(1) of this section for compliance with the requirements of section 42;

(ii) contain at least one of the following requirements:

(A) The owners of at least 50 percent of all low-income housing projects in the Agency's jurisdiction must submit to the Agency for compliance review a copy of the annual income certification, the documentation the owner has received to support that certification, and the rent record for each low-income tenant in at least 20 percent of the low-income units in their projects;

(B) The Agency must inspect at least 20 percent of low-income housing projects each year and must inspect the low-income certification, the documentation the owner has received to support that certification, and the rent record for each low-income tenant in at least 20 percent of the low-income units in those projects; or

(C) The owners of all low-income housing projects must submit to the Agency each year information on tenant

income and rent for each low-income unit, in the form and manner designated by the Agency, and the owners of at least 20 percent of the projects must submit to the Agency for compliance review a copy of the annual income certification, the documentation the owner has received to support that certification, and the rent record for each low-income tenant in at least 20 percent of the low-income units in their projects; and

(iii) Require that the Agency determine which tenants' records are to be inspected or submitted by the owners for review. If a monitoring procedure includes the review provision described in paragraph (c)(2)(ii)(B) of this section, the records to be inspected must be chosen in a manner that will not give owners of low-income housing projects advance notice that their records for a particular year will or will not be inspected. However, an Agency may give an owner reasonable notice that an inspection will occur so that the owner may assemble records (for example, 30 days notice of inspection). See paragraph (d) of this section for the inspection provision that is required to be included in all monitoring procedures.

(3) *Frequency and form of certification.* A monitoring procedure must require that the certifications and reviews of paragraph (c)(2) and (2) of this section be made at least annually covering each year of the 15-year compliance period under section 42(i)(1). The certifications must be made under penalty of perjury. A monitoring procedure may require certifications and reviews more frequently than on a 12-month basis, provided that all months within each 12-month period are subject to certification.

(4) *Exception for certain buildings—(i) In general.* The review requirements under paragraph (c)(2)(ii)(A), (B), and (C) of this section may provide that owners are not required to submit, and the Agency is not required to review, the tenant income certifications, supporting documentation, and rent records for buildings financed by the Farmers Home Administration (FmHA) under the section 515 program, or buildings of which 50 percent or more of the aggregate basis (taking into account the building and the land) is financed with the proceeds of obligations the interest on which is exempt from tax under section 103 (tax-exempt bonds). In order for a monitoring procedure to except these buildings, the Agency must meet the requirements of paragraph (c)(4)(ii) of this section.

(ii) *Agreement and review.* The Agency must enter into an agreement with the FmHA or tax-exempt bond issuer. Under the agreement, the FmHA or tax-exempt bond issuer must agree to provide information concerning the income and rent of the tenants in the building to the Agency. The Agency may assume the accuracy of the information provided by FmHA or the tax-exempt bond issuer without verification. The Agency must review the information and determine that the income limitation and rent restriction of section 42 (g)(1) and (2) are met. However, if the information provided by the FmHA or tax-exempt bond issuer is not sufficient for the Agency to make this determination, the Agency must request the necessary additional income or rent information from the owner of the buildings. For example, because FmHA determines tenant eligibility based on its definition of "adjusted annual income," rather than "annual income" as defined under Section 8, the Agency may have to calculate the tenant's income for section 42 purposes and may need to request additional income information from the owner.

(iii) *Example.* The exception permitted under paragraph (c)(4)(i) and (ii) of this section is illustrated by the following example.

Example. An Agency chooses the review requirement of paragraph (c)(2)(ii)(A) of this section and some of the buildings selected for review are buildings financed by the FmHA. The Agency has entered into an agreement described in paragraph (c)(4)(ii) of this section with the FmHA with respect to those buildings. In reviewing the FmHA-financed buildings, the Agency obtains the tenant income and rent information from the FmHA for 20 percent of the low-income units in each of those buildings. The Agency calculates the tenant income and rent to determine whether the tenants meet the income and rent limitation of section 42 (g)(1) and (2). In order to make this determination, the Agency may need to request additional income or rent information from the owners of the FmHA buildings if the information provided by the FmHA is not sufficient.

(d) *Inspection provision.* Under the inspection provision, the Agency must have the right to perform an on-site inspection of any low-income housing project at least through the end of the compliance period of the buildings in the project. The inspection provision of this paragraph (d) is separate from any review of low-income certifications, supporting documents, and rent records under paragraph (c)(2)(ii) of this section.

(e) *Notification of noncompliance provision—(1) In general.* Under the notification-of-noncompliance provisions, the Agency must be required to give the notice described in

paragraph (e)(2) of this section to the owner of a low-income housing project and the notice described in paragraph (e)(3) of this section to the Service.

(2) *Notice to owner.* The Agency must be required to provide prompt written notice to the owner of a low-income housing project if the Agency does not receive the certification described in paragraph (c)(1) of this section, or does not receive or is not permitted to inspect the tenant income certifications, supporting documentation, and rent records described in paragraph (c)(2)(ii)(A), (B), or (C) of this section (whichever is applicable), or discovers by inspection, review, or in some other manner, that the project is not in compliance with the provisions of section 42.

(3) *Notice to Internal Revenue Service—(i) In general.* The Agency must be required to file Form 8823, "Low-Income Housing Credit Agencies Report of Noncompliance," with the Service no later than 45 days after the end of the correction period (as described in paragraph (e)(4) of this section, including extensions permitted under that paragraph) and no earlier than the end of the correction period, whether or not the noncompliance or failure to certify is corrected. The Agency must explain on Form 8823 the nature of the noncompliance or failure to certify and indicate whether the owner has corrected the noncompliance or failure to certify. Any change in either the applicable fraction or eligible basis under paragraph (c)(1)(ii) and (vii) of this section, respectively, that results in a decrease in the qualified basis of the project under section 42 (c)(1)(A) is noncompliance that must be reported to the Service under this paragraph (e)(3). If an Agency reports on Form 8823 that a building is entirely out of compliance and will not be in compliance at any time in the future, the Agency need not file Form 8823 in subsequent years to report that building's noncompliance.

(ii) *Agency retention of records.* An Agency must retain records of noncompliance or failure to certify for 6 years beyond the Agency's filing of the respective Form 8823. In all other cases, the Agency must retain the certifications and records described in paragraph (c) of this section for 3 years from the end of the calendar year the Agency receives the certifications and records.

(4) *Correction period.* The correction period shall be that period specified in the monitoring procedure during which an owner must supply any missing certifications and bring the project into compliance with the provisions of section 42. The correction period is not to exceed 90 days from the date of the

notice to the owner described in paragraph (e)(2) of this section. An Agency may extend the correction period for up to 6 months, but only if the Agency determines there is good cause for granting the extension.

(f) *Delegation of Authority—(1) Agencies permitted to delegate compliance monitoring functions—(i) In general.* An Agency may retain an agent or other private contractor ("Authorized Delegate") to perform compliance monitoring. The Authorized Delegate must be unrelated to the owner of any building that the Authorized Delegate monitors. The Authorized Delegate may be delegated all of the functions of the Agency, except for the responsibility of notifying the Service under paragraph (e)(3) of this section. For example, the Authorized Delegate may be delegated the responsibility of reviewing tenant certifications and documentation under paragraph (c) (1) and (2) of this section, the right to inspect buildings and records as described in paragraph (d) of this section, and the responsibility of notifying building owners of lack of certification or noncompliance under paragraph (e)(2) of this section. The Authorized Delegate must notify the Agency of any noncompliance or failure to certify.

(ii) *Limitations.* An Agency that delegates compliance monitoring to an Authorized Delegate under paragraph (f)(1)(i) of this section must use reasonable diligence to ensure that the Authorized Delegate properly performs the delegated monitoring functions. Delegation by an Agency of compliance monitoring functions to an Authorized Delegate does not relieve the Agency of its obligation to notify the Service of any noncompliance of which the Agency becomes aware.

(2) *Agencies permitted to delegate compliance monitoring functions to another Agency.* An Agency may delegate all or some of its compliance monitoring responsibilities for a building to another Agency within the State. This delegation may include the responsibility of notifying the Service under paragraph (e)(3) of this section.

(g) *Liability.* Compliance with the requirements of section 42 is the responsibility of the owner of the building for which the credit is allowable. The Agency's obligation to monitor for compliance with the requirements of section 42 does not make the Agency liable for an owner's noncompliance.

(h) *Effective date.* Allocation plans must comply with these regulations by June 30, 1993. The requirement of section 42 (m)(1)(B)(iii) that allocation plans

contain a procedure for monitoring for noncompliance becomes effective on January 1, 1992, and applies to buildings for which a low-income housing credit is, or has been, allowable at any time. Thus, allocation plans must comply with section 42(m)(1)(B)(iii) prior to June 30, 1993, the effective date of these regulations. An allocation plan that complies with these regulations, with the notice of proposed rulemaking published in the Federal Register on December 27, 1991, or with a reasonable interpretation of section 42(m)(1)(B)(iii) will satisfy the requirements of section 42(m)(1)(B)(iii) for periods before June 30, 1993. Section 42(m)(1)(B)(iii) and these regulations do not require monitoring for whether a building or project is in compliance with the requirements of section 42 prior to January 1, 1992. However, if an Agency becomes aware of noncompliance that occurred prior to January 1, 1992, the Agency is required to notify the Service of that noncompliance.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 (Amended)

Par. 4. Section 602.101(c) is amended by adding the following entry to the table:

"1.42-5 1545-1291".

Michael P. Doian,

Acting Commissioner of Internal Revenue.

Approved: August 4, 1992.

Fred T. Goldberg, Jr.,

Assistant Secretary of the Treasury.

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