

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[T.D. 8302]

RIN 1545-AL05

Low-Income Housing Credit for Federally-assisted Buildings

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the low-income housing credit for certain Federally-assisted buildings under section 42 of the Internal Revenue Code of 1986, as enacted by section 252 of the Tax Reform Act of 1986 and, as amended by sections 1002(1) and 4003 of the Technical and Miscellaneous Revenue Act of 1988. The changes to section 42 under section 7108 of the Omnibus Reconciliation Act of 1989 are not reflected in these final regulations but will be the subject of a separate notice of proposed rulemaking. The regulations provide guidance concerning the low-income housing credit allowable for certain Federally-assisted buildings acquired during a 10-year period.

EFFECTIVE DATE: The regulations are effective January 1, 1987.

FOR FURTHER INFORMATION CONTACT: Susan Reaman, 202-377-6349 (not a toll-free number).

SUPPLEMENTARY INFORMATION: 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 requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1005. The estimated average burden associated with the collection of information in this final rule is 3 hours per respondent or recordkeeper. These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents or recordkeepers may require greater or less time, depending upon their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Office of Management and Budget, Paperwork Reduction Project,

Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer TR:FP, Washington, DC 20224.

Background

On November 3, 1987, the Federal Register published a notice of proposed rulemaking (52 FR 42116) by cross-reference to temporary regulations published the same day (52 FR 42098) under section 42 of the Internal Revenue Code of 1986. A number of public comments were received concerning these regulations, and a public hearing was held on March 17, 1988. 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 252 of the Tax Reform Act of 1986 (100 Stat. 2189) as amended by sections 1002(1) and 4003 of the Technical and Miscellaneous Act of 1988 (102 Stat. 3373, 3643) enacted a new low-income housing credit under section 42 of the Internal Revenue Code of 1986. The credit is equal to the applicable percentage of the qualified basis of each qualified low-income building. The temporary regulations published in the Federal Register on November 3, 1987, provide guidance with respect to the credit allowable for certain Federally-assisted buildings acquired during a 10-year period. The low-income housing credit is available to the acquirer of a qualified low-income building for which a special waiver is granted by the Internal Revenue Service in order to avert an assignment of the mortgage secured by the building to the Department of Housing and Urban Development or the Farmers' Home Administration, or to avert a claim against a Federal mortgage insurance fund with respect to a mortgage which is so secured.

Public Comment

Several commentators suggested that the waiver under section 42(d)(6) should apply to a project, as well as a building. In response to this comment, proposed § 1.42-2(d)(3) has been revised to indicate that a single waiver application can be filed for a project consisting of multiple buildings as long as the information required for each building is identified by building address. Proposed § 1.42-2(d)(3) has also been revised to indicate that a waiver application can be filed for specific buildings that are Federally-assisted in a project consisting of multiple buildings that may or may not be Federally-assisted.

Several commentators requested that the certification that Federal mortgage funds are at risk should come from the Federal agency, rather than the taxpayer. This suggestion has been adopted, and proposed § 1.42-2(c)(3) has been revised to indicate that the Federal agency is to provide such certification in the form of a letter or other written statement made or received and approved by the national office of the Federal agency.

Several commentators contended that it is unclear what documentation taxpayers must provide to evidence the specified Federal agency action that must have been taken to demonstrate that a waiver is necessary to avert Federal mortgage funds being at risk. In response to this, proposed § 1.42-2(c)(3) has been revised to indicate that a letter or other written statement made or received and approved by the national office of the Federal agency is sufficient specified Federal agency action.

Several commentators urged that a building should qualify as troubled if it shows a history of financial distress, whether or not the owner has defaulted on a mortgage payment. In response, the proposed rule has been revised to indicate that designation of troubled status must be based on a review by the Federal agency of the financial condition of the building or project and on a determination by the agency of a history of financial distress or mortgage defaults. See § 1.42-2(c)(3)(ii)(D).

A commentator urged that the granting of a waiver under section 42(d)(6)(A) should be contingent on approval by the Federal agency of the past performance of the current owner/seller of the building or project. Because the Federal agency already has the ability to take this factor into account under proposed § 1.42-2(c)(3) (relating to action by the Department of Housing and Urban Development or the Farmers' Home Administration), this comment is not specifically incorporated in the final regulations.

A commentator requested that the waiver under section 42(d)(6) should be available where a change in ownership is being forced due to conditions beyond the control of the owner of the building or project, such as death or bankruptcy. Under section 42(d)(6)(A) and proposed § 1.42-2(c)(3) the Federal agency already has sufficient latitude to consider circumstances such as death or bankruptcy. Therefore, the final regulations do not specifically adopt this recommendation.

A commentator stated that proposed § 1.42-2(a) should explicitly reference section 42(d)(2)(A)(i)(II) which permits

the inclusion in eligible basis of amounts chargeable to capital account and incurred by the taxpayer (before the close of the 1st taxable year of the credit period for such building) for property (or additions or improvements to property) of a character subject to the allowance for depreciation. In response to this comment, proposed § 1.42-2(a) has been revised to contain a reference to, and determining eligible basis under section 42(d)(2).

A commentator recommended adding language to proposed § 1.42-2(c)(4) (relating to the waiver requirement that no prior owner was allowed a low-income housing credit for the building) to cover situations where the building or project is acquired after the end of the 15-year compliance period in section 42(l)(1). This recommendation has not been adopted since section 42(n) provides that the State housing credit ceiling is zero for any calendar year after 1989.

A commentator requested that since the existence of a mortgage is a prerequisite to a waiver application, proposed § 1.42-2(d)(2)(ix) should change the phrase "any outstanding mortgage" to "the outstanding mortgage" and delete the phrase "if any". The proposed rule has been clarified in response to this request. See § 1.42-2(d)(2)(vii).

A commentator requested clarification concerning the effective date of a waiver. In response to this, proposed § 1.42-2(d)(4) has been clarified to state that the waiver is effective when granted by the Internal Revenue Service. Previously, it was stated that a waiver will be effective when granted but in no event later than 60 days after a taxpayer files a substantially complete application for waiver. Some taxpayers believed this language granted an automatic waiver, if a waiver was not granted within 60 days. The intent behind the 60 day period was that if a waiver was granted after the expiration of 60 days from the date the application was filed, the waiver would be effective starting 60 days after the filing date. Given this confusion, the 60 day language has been deleted from the proposed § 1.42-2(d)(4).

Several commentators urged that non-Federally-assisted buildings or projects should be eligible for the waiver of the 10-year rule under section 42(d)(6). This suggestion has not been adopted because only a Federally-assisted building, as defined in section 42(d)(6)(B), is eligible to apply for the waiver.

Several commentators contended that buildings or projects that have already

been foreclosed upon by the Department of Housing and Urban Development or the Farmers' Home Administration should be eligible for the waiver of the 10-year rule under section 42(d)(6). This suggestion has not been adopted as it is inconsistent with the section 42(d)(6)(A) requirement that a waiver be necessary "to avert an assignment of the mortgage" or "to avert a claim against a Federal mortgage insurance fund."

Several commentators stated that the regulations should address "other circumstances of financial distress" contained in section 42(d)(6)(A)(iii) with respect to eligibility for waiver of the 10-year rule contained in section 42(d)(2)(B)(ii). Section 42(d)(6)(A)(iii) was eliminated by the Technical and Miscellaneous Revenue Act of 1988.

The Internal Revenue Service also invited public comments on any other issues arising under section 42 with respect to which guidance is needed. A number of comments were received, and while those comments are not discussed in this Treasury decision, they will be taken into account in promulgating other regulations under section 42. The Internal Revenue Service appreciates the submission of those comments.

Special Analyses

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

Although a notice of proposed rulemaking that solicited public comment was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Drafting Information

The principal author of these regulations is Susan Resman of the Office of the Assistant Chief Counsel (Pass-throughs and Special Industries), Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulations on matters of both substance and style.

List of Subjects

26 CFR 1.0-1 through 1.58-8

Income taxes, Tax liability, Tax rates, Credits.

26 CFR 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

The amendments to 26 CFR parts 1 and 602 are as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1988

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

Authority: 26 U.S.C. 7505. Section 1.42-2 also issued under 26 U.S.C. 42(m).

§ 1.42-1 [Removed and reserved]

Par. 2 New §§ 1.42-0 and 1.42-2 are added in the appropriate place and § 1.42-1 is removed and reserved. The added provisions read as follows:

§ 1.42-0 Table of contents.

This section lists the paragraphs contained in §§ 1.42-1 and 1.42-2.

§ 1.42-1 [Reserved]

§ 1.42-2 Waiver of requirement that an existing building eligible for the low-income housing credit was last placed in service more than 10 years prior to acquisition by the taxpayer.

- (a) Low-income housing credit for existing building
- (b) Waiver of 10-year holding period requirement
- (c) Waiver requirements
 - (1) Federally-assisted building
 - (2) Federal mortgage funds at risk
 - (3) Statement by the Department of Housing and Urban Development or the Farmers' Home Administration
 - (4) No prior credit allowed
- (d) Application for waiver
 - (1) Time and manner
 - (2) Information required
 - (3) Other rules
 - (4) Effective date of waiver
 - (5) Attachment to return
- (e) Effective date of regulations

§ 1.42-1 [Reserved]

§ 1.42-2 Waiver of requirement that an existing building eligible for the low-income housing credit was last placed in service more than 10 years prior to acquisition by the taxpayer.

(a) *Low-income housing credit for existing building.* Section 42 provides that for purposes of section 38, new and existing qualified low-income buildings are eligible for a low-income housing credit. The eligibility rules for new and existing buildings differ. Under section 42(d)(2), an existing building may be eligible for the low-income housing credit based upon the acquisition cost and amounts chargeable to capital

account (to the extent properly included in eligible basis) if—

(1) The taxpayer acquires the building by purchase (as defined in section 179(d)(2), as applicable under section 42(d)(2)(D)(ii)(I)).

(2) There is a period of at least 10 years between the date of the building's acquisition by the taxpayer and the later of—(i) The date the building was last placed in service, or

(ii) The date of the most recent nonqualified substantial improvement of the building, and

(3) The building was not previously placed in service by the taxpayer, or by a person who was a related person (as defined in section 42(d)(2)(D)(iii)(II)) with respect to the taxpayer as of the time the building was last previously placed in service.

(b) *Waiver of 10-year holding period requirement.* Section 42(d)(6) provides that a taxpayer may apply for a waiver of the 10-year holding period requirement specified in paragraph (a)(2) of this section. The Internal Revenue Service will grant a waiver only if—

(1) The existing building satisfies all of the requirements in paragraph (c) of this section, and

(2) The taxpayer makes an application in conformity with the requirements in paragraph (d) of this section.

(c) *Waiver requirements—(1) Federally-assisted building.* To satisfy the requirement of this paragraph, a building must be a Federally-assisted building. The term "Federally-assisted building" means any building which is substantially assisted, financed, or operated under section B of the United States Housing Act of 1937, section 221(d)(3) or 236 of the National Housing Act, or section 515 of the Housing Act of 1949, as such acts were in effect on October 22, 1986.

(2) *Federal mortgage funds at risk.* To satisfy the requirement of this paragraph, Federal mortgage funds must be at risk with respect to a mortgage that is secured by the building or a portion of the project of which the building is a part. For purposes of this paragraph, Federal mortgage funds are at risk if, in the event of a default by the mortgagor on the mortgage secured by the building or the project of which the building is a part—

(i) The mortgage could be assigned to the Department of Housing and Urban Development or the Farmers' Home Administration, or

(ii) There could arise a claim against a Federal mortgage insurance fund (or such Department or Administration).

(3) Statement by the Department of Housing and Urban Development or the Farmers' Home Administration. (i) To satisfy the requirement of this paragraph, a letter or other written statement must be made or received and approved by the national office of the Department of Housing and Urban Development or the Farmers' Home Administration ("the Federal agency"). This letter or statement shall include the following:

(A) A statement that, as of the earlier of the time of the taxpayer's acquisition of the building or the taxpayer's application for a waiver, the building is a Federally-assisted building within the meaning of paragraph (c)(1) of this section and identifies the source of Federal assistance.

(B) A statement that a waiver of the 10-year holding period requirement is necessary to avert Federal mortgage funds being at risk within the meaning of paragraph (c)(2) of this section; and

(C) A statement that the Federal agency has taken a Federal agency action as described in paragraph (c)(3)(ii) of this section.

(ii) The following specified Federal agency actions shall be the only means of satisfying the requirement of this paragraph:

(A) The Federal agency intends to accept an assignment of a mortgage secured by the building or the project of which the building is a part, and such assignment requires payments by the agency or a mortgage insurance fund maintained by the agency to the prior mortgagee;

(B) The Federal agency or a mortgage insurance fund maintained by the agency intends to accept, as a consequence of foreclosure proceedings or otherwise, conveyance of the building or the project of which the building is a part;

(C) The Federal agency or a mortgage insurance fund maintained by the agency intends, as a consequence of default, to take possession of, hold title to, or otherwise assume ownership of the building or the project of which the building is a part; or

(D) The Federal agency has designated the building or the project of which the building is a part as a troubled building or project. A troubled building or project must satisfy the following requirements:

(1) Designation of troubled status must be based on a review by the Federal agency of the financial condition of the building or project and on a determination by the Federal agency of a history of financial distress or mortgage defaults;

(2) Designation of troubled status must be made or received and approved by the national office of the Federal agency; and

(3) Federal agency regulations or procedures must provide that, in the event of transfer of the ownership of a designated troubled building or project, the building or project may be subject to continued review by the Federal agency. Each Federal agency may prescribe its own standards and procedures for designating a troubled building or project so long as such standards are consistent with the requirements of this paragraph (c)(3)(ii)(D).

(4) No prior credit allowed. The requirement of this paragraph is satisfied only if no prior owner was allowed a low-income housing credit under section 42 for the building.

(d) Application for waiver—(1) Time and manner. In order to receive a waiver of the 10-year holding period requirement specified in paragraph (a)(2) of this section, a taxpayer must file an application (including the applicable user fee) that complies with the requirements of this paragraph (d) and Rev. Proc. 90-1, 1990-1 I.R.B. 8 (or any subsequent applicable revenue procedure). The application must be filed by a taxpayer who has acquired the building by purchase or who has a binding contract to purchase the building. Such binding contract may be conditioned upon the granting of a waiver under this section. The application may be filed at any time after a binding contract has been entered into, but no later than 12 months after the taxpayer's acquisition of the building. An application for a waiver of the 10-year holding period requirement must not contain a request for a ruling on any other issue arising under section 42 or other sections of the Internal Revenue Code. An application for a waiver of the 10-year holding period requirement must be mailed or delivered to the address listed in section 3.01 of Rev. Proc. 90-1 (or any subsequent applicable revenue procedure).

(2) Information required. An application for a waiver of the 10-year holding period requirement must contain the following information:

(i) The taxpayer's name, address and taxpayer identification number;

(ii) The name (if any) and address of the acquired building and the project (if any) of which it is a part;

(iii) The date of acquisition or the date of the binding contract for acquisition of the building by the taxpayer and the expected date of acquisition, the amount of consideration paid or to be paid for the acquisition (including the value of any liabilities assumed by the taxpayer);

and the taxpayer's certification that such acquisition is by purchase (as defined in section 179(d)(2)), as applicable under section 42

(d)(2)(D)(iii)(I);

(iv) The identity of the person from whom the building is acquired, and whether such person is a Federal agency, a mortgagee holding title to the building, or the mortgagor or prior owner;

(v) The date the building was last placed in service and the date of the most recent (if any) nonqualified substantial improvement of the building (as defined in section 42(d)(2)(D)(i));

(vi) The taxpayer's certification that the building was not previously placed in service by the taxpayer, or by a person who was a related person (as defined in section 42(d)(2)(D)(iii)(II)) with respect to the taxpayer as of the time the building was last placed in service;

(vii) The amount and disposition (e.g., discharge, assignment, assumption, or refinancing) of the outstanding mortgage at the time of acquisition and the identities of the mortgagee and mortgagor;

(viii) The taxpayer's certification that no prior owner was allowed a low-income housing credit under section 42 for the building (made to the best of the taxpayer's knowledge, with no documentation from other persons needed to be submitted); and

(ix) The statement from the Federal agency required by paragraph (c)(3)(i) of this section.

(3) Other rules. (i) In the event that an acquired building will be owned by more than one taxpayer, a single application for waiver may be filed by one taxpayer on behalf of the co-owners if the application contains the names, addresses and taxpayer identification numbers of the other owners. A general partner or a designated limited partner may file an application for waiver on behalf of a partnership.

(ii) In the event that multiple Federally-assisted buildings in a project are being acquired by the taxpayer, a single application for waiver with respect to such buildings may be filed if the application contains the required information set out for the address of each Federally-assisted building involved.

(iii) In the event that specific Federally-assisted buildings are being acquired by the taxpayer in a project consisting of multiple buildings that may or may not be Federally-assisted, a single application for waiver with respect to the Federally-assisted

buildings being acquired may be filed if the application contains the required information set out for the address of each Federally-assisted building being acquired.

(4) *Effective date of waiver.* A waiver will be effective when granted in writing by the Internal Revenue Service after submission of a completed application for waiver filed under this paragraph (d).

(5) *Attachment to return.* A waiver letter granted by the Internal Revenue Service shall be filed with the taxpayer's Federal income tax return for the first taxable year the low-income housing credit is claimed by the taxpayer.

(e) *Effective date of regulations.* The provisions of § 1.42-2 are effective for buildings placed in service by the taxpayer after December 31, 1986.

§ 1.42-2T (Removed)

Par. 3. Section 1.42-2T is hereby removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 28 U.S.C. 7905.

Par. 5. The table in § 602.101 (c) is amended by removing the entry for § 1.42-2T and adding in the appropriate place "§ 1.42-2 1545-1005".

Michael J. Murphy,
Acting Commissioner of Internal Revenue.

Approved:
Kenneth W. Gideon,
Assistant Secretary of the Treasury.

February 2, 1990.

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