Section.—42 Low-Income Housing Credit

26 CFR 1.42–5: Monitoring compliance with low-income housing credit requirements.

T.D. 8859

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Compliance Monitoring and Miscellaneous Issues Relating to the Low-Income Housing Credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding the procedures for compliance monitoring by state and local housing agencies (Agencies) with the requirements of the low-income housing credit; the requirements for making carryover allocations; the rules for Agencies' correction of administrative errors or omissions; and the independent verification of information on sources and uses of funds submitted by taxpayers to Agencies. These final regulations affect owners of low-income housing projects who claim the credit and the Agencies who administer the credit.

DATES: *Effective Dates*: These regulations are effective January 1, 2001, except that the amendments made to §§1.42–5(c)(5) and (e)(3)(i), and 1.42–13 are effective January 14, 2000, and the amendment made to §1.42–6(d)(4)(ii) is effective January 1, 2000.

Applicability Dates: For dates of applicability of the amendments to §1.42–5, see §1.42–5(h). For date of applicability of the amendment made to §1.42–6, see §1.42–12(c). For date of applicability of the amendments made to §1.42–13, see §1.42–13(d). For date of applicability of §1.42–17, see §1.42–17(b).

FOR FURTHER INFORMATION CONTACT: Paul Handleman, (202) 622-3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1357. Responses to these collections of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For §1.42–5, the estimated annual burden per respondent varies from .5 hour to 3 hours for taxpayers and 250 to 5,000 hours for Agencies, with an estimated average of 1 hour for taxpayers and 1,500 hours for Agencies. For §1.42–13, the estimated annual burden per respondent varies from .5 hour to 10 hours for taxpayers and Agencies, with an estimated average of 3.5 hours for taxpayers and 3 hours for Agencies. For §1.42–17, the estimated annual burden per respondent varies from .5 hour to 2 hours for taxpayers and .5 hour to 5 hours for Agencies, with an estimated average of 1 hour for taxpayers and 2 hours for Agencies.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS: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.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On January 8, 1999, the IRS published proposed regulations (REG–114664–97, 1999–11 I.R.B. 21) in the **Federal Register** (64 FR 1143) inviting comments under section 42. A public hearing was held May 27, 1999. Numerous comments have been received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury Decision.

Public Comments

A. *Compliance Monitoring*

1. *Inspection Requirement for New Buildings.*

The proposed regulations require that, by the end of the calendar year following the year the last building in a project is placed in service, the Agency conduct on-site inspections of the projects and review the low-income certification, the documentation supporting such certification, and the rent record for each tenant in the project. Most commentators view the requirement for reviewing all tenant records for all buildings in a project as unnecessary and burdensome. Most commentators suggest limiting inspections for new buildings to 20 percent of the project's low-income units. Commentators also suggest extending the time limit for inspecting new buildings to the end of the calendar year following the first year of the credit period or at least until a reasonable time after the Agency issues Form 8609, "Low-Income Housing Credit Allocation Certification." This added flexibility would allow the Agency to combine a physical inspection with a file review of the first year of the credit period.

In response to the comments, the final regulations reduce the inspection burden for new buildings by requiring the Agency to conduct on-site inspections of all new buildings in the project and, for at least 20 percent of the project's low-income units, to inspect the units and review the low-income certifications, the documentation supporting the certifications, and the rent records for the tenants in those units. To allow the Agency sufficient time to review the tenant files for the first year of the credit period, the final regulations extend the time limit for inspecting new buildings to the end of the second calendar year following the year the last building in the project is placed in service.

2. *Three-year Inspection Requirement.*

The proposed regulations require that,

at least once every 3 years, each Agency conduct on-site inspections of all buildings in each low-income housing project and, for each tenant in at least 20 percent of the project's low-income units selected by the Agency, review the low-income certification, the documentation supporting such certification, and the rent record.

Most commentators agree with requiring physical inspections of the buildings at least once every 3 years. However, commentators recommend reviewing tenant income and rent records once every 5 years, which is one of the options under the current compliance monitoring regulations (see §1.42–5(c)(2)(ii)(B) requiring an Agency to review tenant files for 20 percent of the low-income housing projects each year). Commentators also recommend reviewing tenant files either on-site or at other locations, including desk audits.

Although the physical inspection and file review requirements for new buildings are relaxed in the final regulations, the final regulations retain the 3-year inspection cycle for existing buildings. The final regulations do not separate the physical inspection and file review cycles (every 3 years for physical inspections and every 5 years for file reviews) as suggested by commentators because it is administratively complete to do both during the same year. The tenant income and rent restrictions in section 42(g) are equally important as the habitability standards for a low-income unit in section 42(i)(3)(B)(ii). The final regulations adopt the suggestion that the file review may be done wherever the tenant files are maintained.

3. *Health, Safety, and Building Code Inspections.*

The proposed regulations require the Agency to determine whether the project is suitable for occupancy, taking into account local health, safety, and building codes. Many commentators object to this requirement as too costly and unadministerable because building codes vary considerably within states. Commentators also asked for guidelines as to what constitutes an "inspection." Some commentators propose defining an inspection as looking at selected units in the building and common areas for visible problems or defects without applying the local health, safety, and building codes standards. One commentator suggests inspections based on a complaint from the local jurisdiction or from a tenant. Some commentators suggest using a uniform physical standard such as the uniform physical condition standards for public housing established by the Department of Housing and Urban Development (HUD) in 24 CFR 5.703.

Section 42(i)(3)(B)(i) excludes from the definition of a "low-income unit" a unit that is not suitable for occupancy. Under section 42(i)(3)(B)(ii), suitability of a unit for occupancy shall be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes. Recognizing that these codes vary considerably within states, the final regulations require an Agency to determine whether a low-income housing project satisfies these codes, or satisfies the HUD uniform physical condition standards. The HUD standards are intended to ensure that housing is decent, safe, sanitary, and in good repair. Though it would be appropriate that an Agency use HUD's inspection protocol under 24 CFR 5.705, the final regulations do not mandate use of HUD's inspection protocol because to do so could increase costs to the Agencies as well as limit their latitude in applying standards consistent with their own operating procedures and practices. The final regulations except a building from the inspection requirement if the building is financed by the Rural Housing Service (RHS) under the section 515 program, the RHS inspects the building (under 7 CFR part 1930(c)), and the RHS and Agency enter into a memorandum of understanding, or other similar arrangement, under which the RHS agrees to notify the Agency of the inspection results. Irrespective of the physical inspection standard selected by the Agency, a low-income housing project under section 42 must continue to satisfy local health, safety, and building codes.

The proposed regulations limit an Agency's delegation of the physical inspection of a project to only a state or local government unit responsible for making building code inspections. Commentators suggest expanding the delegation of inspections to professional firms. The final regulations remove the delegation limitation and Agencies may delegate the physical inspection requirement to state or local governmental agencies, HUD, or private contractors.

4. *Local Reports of Building Code Violations.*

The proposed regulations require the owner of a low-income housing project to certify that for the preceding 12-month period the state or local government unit responsible for making building code inspections didnot issue a report of a violation for the project. If the governmental unit issued a report of a violation, the owner is required to attach a copy of the report of the violation to the annual certification submitted to the Agency.

A commentator noted that the number of violations attached to the annual owner certification would be considerable because even the highest quality rental housing operations do not have an inspection without a report or notice of some violation. Two commentators suggest attaching reports only for violations that have not been corrected prior to filing the annual owner certification or requiring that owners only attach reports for "major" violations. The commentators suggest defining major violations as violations not corrected within 90 days of the notice of violation or violations where the cost to comply exceeds $2,500. A commentator suggests that Agencies be allowed to distinguish between minor technical violations and serious violations (i.e., lack of heat or hot water, hazardous conditions, and security) in reporting noncompliance.

Though a minor violation will not lead to the disallowance or recapture of section 42 credits, a series of minor violations may be the equivalent of a major violation resulting in disallowance or recapture of credits. Determining the difference between a major and minor violation is subjective. The final regulations do not exclude minor violations from the reporting and recordkeeping requirement. However, to reduce the inspection violation paperwork, the final regulations require that the owner must either attach a statement summarizing the violations or a copy of each violation report to the annual owner certification submitted to the Agency. The owner must state on the certification whether the violation has been corrected. In addition, the final regulations require that the owner retain the original violation report for the Agency's physical inspection. Retention of the

original violation report is not required once the Agency reviews the violation and completes its inspection, unless the violation remains uncorrected.

5. *Correction of Noncompliance or Failure to Certify.*

The final regulations adopt commentators' suggestion to limit to a 3-year period after the end of the correction period in §1.42–5(e)(4) the requirement that Agencies file Form 8823, "Low-Income Housing Credit Agencies Report of Noncompliance," with the IRS reporting the correction of the noncompliance or failure to certify.

6. *Compliance Monitoring Effective Dates.*

Commentators suggest an effective date of at least one year after the final regulations are published in the Federal Register. Commentators also recommend onsite inspections apply only to new buildings allocated section 42 credits after the effective date of the final regulations.

Because the amendments to the compliance monitoring regulations will require amendments to qualified allocation plans, the final regulations relating to compliance generally contain a January 1, 2001, effective date. Thus, the requirements to attach local health, safety, or building code violations to the annual owner certification and to inspect buildings and review tenant files for existing projects are effective January 1, 2001. The inspection requirement and tenant file review for new buildings is effective for buildings placed in service on or after January 1, 2001.

7. *Section 8 and Federal Civil Rights Laws.*

Two commentators state that insufficient controls are in place to ensure that low-income housing projects adhere to the requirement in section 42(h)(6)(B)(iv) of nondiscrimination against Section 8 voucher or certificate holders. The commentators suggest that the IRS could help compensate for lack of controls by working with HUD to ensure that Section 8 voucher or certificate holders are aware of, and have access to, low-income housing projects. The commentators also suggest that Agencies provide regional HUD offices a list of low-income housing projects in that state, with information that would be helpful for prospective tenants. One commentator suggests that the prohibition on discrimination based on Section 8 status be clarified to exclude policies that bar Section 8 tenants but have no substantial business justification. For example, low-income housing projects should not be permitted to exclude Section 8 voucher or certificate holders through a rule that requires every applicant to have income equal to at least three times the total rent.

The commentators also suggest that the Agencies should be required to develop a plan for educating applicants and owners of projects of the prohibition against discrimination on the basis of Section 8 voucher or certificate status. They recommend that the Agencies should be required to have a procedure for accepting and processing complaints about discrimination against Section 8 voucher or certificate holders. They also recommend that IRS and HUD should work together to study the circumstances under which Section 8 voucher or certificate holders are, or are not, accessing projects.

Section 42(h)(6)(A) provides that no credit shall be allowed by reason of section 42 with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year. Section 42(h)(6)(B)(iv) defines the term "extended low-income housing commitment" to include any agreement between the taxpayer and the housing credit agency that prohibits the refusal to lease to a holder of a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937 because of the status of the prospective tenant as such a holder. To help monitor compliance with section 42(h)(6)(B)(iv), the final regulations amend the annual owner certification relating to the extended low-income housing commitment under §1.42–5(c)(1)(xi) to require owners to certify that the owner has not refused to lease a unit in the project to a Section 8 applicant because the applicant holds a Section 8 voucher or certificate.

The IRS has informed HUD of the comments received about preventing discrimination based on Section 8 status. Agencies should provide HUD with publicly available information on section 42 low-income housing projects if HUD requests it.

A commentator also suggests that the compliance monitoring regulations be amended to acknowledge the authority of Title VIII of the 1968 Civil Rights Act, as well as HUD's Title VIII regulations; specify the civil rights obligations of the Agencies; and specify what developers and owners of projects must do to satisfy their civil rights obligations.

To monitor for compliance with the Fair Housing Act, the final regulations amend the annual owner certification relating to the general public use requirement in §1.42–5(c)(1)(v) to require owners to certify that no finding of discrimination under the Fair Housing Act has occurred for the project (a finding of discrimination includes an adverse final decision by HUD, an adverse final decision by a substantially equivalent state or local fair housing agency, or an adverse judgment from a Federal court).

B. *Sources and Uses of Funds*

Section 42(m)(2)(A) requires Agencies to limit the housing credit dollar amount allocated to a project to only the amount necessary for the financial feasibility of a project and its viability as a qualified low-income project through the credit period. The proposed regulations require an Agency to evaluate the housing credit dollar amount at four times: (1) at application for the housing credit dollar amount, (2) the allocation of the housing credit dollar amount, (3) the date the building is placed in service, and (4) after the building is placed in service, but before the Agency issues the Form 8609. Commentators recommend elimination of the evaluation at the placed-in-service date. In practice, Agencies currently evaluate the credit amount at the three other times. The final regulations adopt the recommendation by deleting the fourth time requirement and clarifying that the placed-in-service evaluation may occur not later than the date the Agency issues the Form 8609.

Commentators are concerned that the opinion by a certified public accountant, based upon the accountant's audit or examination, on the financial determinations and certifications required in the proposed regulations, could have significant cost implications, particularly for smaller developers. Commentators suggest limiting the requirement to projects with 25 or more units, or projects with total development costs of $5 million or more.

The third-party validation on financial information was recommended in the report by the General Accounting Office (GAO), "Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program," (GAO/GGD/RCED-97–55), dated March 28, 1997. The GAO report states on page 93 that an accounting firm with a tax credit speciality would charge in the $5,000 to $7,500 range per engagement for tax credit certifications (opinion on total costs, eligible basis, and tax credit amount) prepared on the basis of an audit done in accordance with AICPA audit standards even for projects costing upwards of $5 million to $10 million. As a percentage of development costs, the CPA tax credit certifications represent a minimal cost for validating financial information. However, in recognition that the cost may be burdensome for smaller developers, the final regulations limit the requirement for an audited schedule of costs for projects with more than 10 units.

Two commentators were concerned that the meaning of the term "financial determinations and certifications" is unclear. A CPA would not be able to evaluate what needs to be audited and whether there are relevant and reliable criteria against which the information can be evaluated. To conduct an audit or attestation engagement, CPAs require that the subject matter be defined and that such subject matter be capable of evaluation against reasonable criteria. Reasonable criteria are essential so that CPAs using the same criteria will be able to arrive at similar conclusions.

Another concern expressed by commentators involved uncertainty as to whether the CPA is being asked to report on financial information that is only historical or whether the CPA is also being asked to examine prospective financial information. CPAs can compile or examine and report on certain types of prospective financial information. However, such engagements generally are more costly than audits of historical information because of minimum presentation guidelines required by professional standards as well as increased risk associated with future-oriented information. The commentators believe that if an Agency were to require CPAs to be associated with prospective financial information, the related costs to the taxpayer may far exceed any perceived benefits to the Agency. Accordingly, the final regulations have been revised to specify that the CPA's opinion only relates to historical project costs.

C. *Correction of Administrative Errors and Omissions*

Commentators recommend filing the corrected allocation document with the current year's Form 8610, "Annual Low-Income Housing Credit Agencies Report," instead of amending the Form 8610 for the year the allocation was made. Because the administrative errors covered by the automatic approval provision will not have an effect on the total amount of credit the Agency allocated to the building(s) or project, commentators view an amended Form 8610 as unnecessary. Agency recordkeeping would be simplified if all corrected allocation documents could be submitted with the current year's Form 8610. The final regulations adopt this recommendation.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collections of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the burden on taxpayers is minimal and the burden on small entity Agencies is not significant. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these 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. Handleman, Office of the Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.42–17 also issued under 26 U.S.C. 42(n); * * *

Par. 2. Section 1.42–5 is amended by:

1. Removing the word "Revenue" in paragraph (b)(1)(iv) and adding "Omnibus Budget" in its place.

2. Adding paragraph (b)(3).

3. Revising paragraphs (c)(1)(v), (c)(1)(vi), (c)(1)(xi), (c)(2)(ii), and (c)(2)(iii).

4. Removing the word "project" in paragraph (c)(1)(x) and adding "building" in its place.

5. Removing the word "and" at the end of paragraph (c)(1)(x).

6. Adding paragraph (c)(1)(xii).

7. Removing the language "paragraph (c)(2)(ii)(A), (B), and (C) of this section" from the first sentence in paragraph (c)(4)(i) and adding "paragraph (c)(2)(ii) of this section" in its place.

8. Removing the language "Farmers Home Administration (FmHA)" in the first sentence in paragraph (c)(4)(i) and adding "Rural Housing Service (RHS), formerly known as Farmers Home Administration," in its place.

9. Removing the language "FmHA" in paragraph (c)(4)(ii) and adding "RHS" in its place in each place it appears.

10. Removing the language "An Agency chooses the review requirement of paragraph (c)(2)(ii)(A) of this section and some of the buildings selected for review are" from the first sentence in the example in paragraph (c)(4)(iii) and adding "An Agency selects for review" in its place.

11. Removing the language "FmHA" in paragraph (c)(4)(iii) *Example* and adding "RHS" in its place in each place it appears.

12. Adding paragraph (c)(5).

13. Revising paragraph (d).

14. Removing the language "(c)(2)(ii)(A), (B), or (C) of this section (whichever is applicable)" from paragraph (e)(2) and adding the language "(c)(2)(ii) of this section" in its place.

15. Adding a sentence at the end of paragraph (e)(3)(i).

16. Removing the language "paragraph (e)(3) of this section" in the third sentence in paragraph (f)(1)(i) and adding "paragraphs (c)(5) and (e)(3) of this section" in its place.

17. Adding three sentences at the end of paragraph (h).

The revisions and additions read as follows:

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

* * * * *

(b) * * *

(3) *Inspection record retention provision.* Under the inspection record retention provision, the owner of a low-income housing project must be required to retain the original local health, safety, or building code violation reports or notices that were issued by the State or local government unit (as described in paragraph (c)(1)(vi) of this section) for the Agency's inspection under paragraph (d) of this section. Retention of the original violation reports or notices is not required once the Agency reviews the violation reports or notices and completes its inspection, unless the violation remains uncorrected.

(c) * * * (1) * * *

(v) All units in the project were for use by the general public (as defined in §1.42–9), including the requirement that no finding of discrimination under the Fair Housing Act, 42 U.S.C. 3601 – 3619, occurred for the project. A finding of discrimination includes an adverse final decision by the Secretary of the Department of Housing and Urban Development (HUD), 24 CFR 180.680, an adverse final decision by a substantially equivalent state or local fair housing agency, 42 U.S.C. 3616a(a)(1), or an adverse judgment from a federal court;

(vi) The buildings and low-income units in the project were suitable for occupancy, taking into account local health, safety, and building codes (or other habitability standards), and the State or local government unit responsible for making local health, safety, or building code inspections did not issue a violation report for any building or low-income unit in the project. If a violation report or notice was issued by the governmental unit, the owner must attach a statement summarizing the violation report or notice or a copy of the violation report or notice to the annual certification submitted to the Agency under paragraph (c)(1) of this section. In addition, the owner must state whether the violation has been corrected;

* * * * *

(xi) An extended low-income housing commitment as described in section 42(h)(6) was in effect (for buildings subject to section 7108(c)(1) of the Omnibus Budget Reconciliation Act of 1989, 103 Stat. 2106, 2308 - 2311 (1989)), including the requirement under section 42(h)(6)(B)(iv) that an owner cannot refuse to lease a unit in the project to an applicant because the applicant holds a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937, 42 U.S.C. 1437f (for buildings subject to section 13142(b)(4) of the Omnibus Budget Reconciliation Act of 1993, 107 Stat. 312, 438 – 439 (1993)); and

(xii) All low-income units in the project were used on a nontransient basis (except for transitional housing for the homeless provided under section 42(i)(3)(B)(iii) or single-room-occupancy units rented on a month-by-month basis under section 42(i)(3)(B)(iv)).

(2) * * *

(ii) Require that with respect to each low-income housing project—

(A) The Agency must conduct on-site inspections of all buildings in the project by the end of the second calendar year following the year the last building in the project is placed in service and, for at least 20 percent of the project's low-income units, inspect the units and review the low-income certifications, the documentation supporting the certifications, and the rent records for the tenants in those units; and

(B) At least once every 3 years, the Agency must conduct on-site inspections of all buildings in the project and, for at least 20 percent of the project's low-income units, inspect the units and review the low-income certifications, the documentation supporting the certifications, and the rent records for the tenants in those units; and

(iii) Require that the Agency randomly select which low-income units and tenant records are to be inspected and reviewed by the Agency. The review of tenant records may be undertaken wherever the owner maintains or stores the records (either on-site or off-site). The units and tenant records to be inspected and reviewed must be chosen in a manner that will not give owners of low-income housing projects advance notice that a unit and tenant records for a particular year will or will not be inspected and reviewed. However, an Agency may give an owner reasonable notice that an inspection of the building and low-income units or tenant record review will occur so that the owner may notify tenants of the inspection or assemble tenant records for review (for example, 30 days notice of inspection or review).

* * * * *

(5) *Agency reports of compliance monitoring activities.* The Agency must report its compliance monitoring activities annually on Form 8610, "Annual Low-Income Housing Credit Agencies Report."

(d) *Inspection provision*—(1) *In general*. 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 a separate requirement from any tenant file review under paragraph (c)(2)(ii) of this section.

(2) *Inspection standard.* For the on-site inspections of buildings and low- income units required by paragraph (c)(2)(ii) of this section, the Agency must review any local health, safety, or building code violations reports or notices retained by the owner under paragraph (b)(3) of this section and must determine—

(i) Whether the buildings and units are suitable for occupancy, taking into account local health, safety, and building codes (or other habitability standards); or

(ii) Whether the buildings and units satisfy, as determined by the Agency, the uniform physical condition standards for public housing established by HUD (24 CFR 5.703). The HUD physical condition standards do not supersede or preempt local health, safety, and building codes. A

low-income housing project under section 42 must continue to satisfy these codes and, if the Agency becomes aware of any violation of these codes, the Agency must report the violation to the Service. However, provided the Agency determines by inspection that the HUD standards are met, the Agency is not required under this paragraph (d)(2)(ii) to determine by inspection whether the project meets local health, safety, and building codes.

(3) *Exception from inspection provision.* An Agency is not required to inspect a building under this paragraph (d) if the building is financed by the RHS under the section 515 program, the RHS inspects the building (under 7 CFR part 1930), and the RHS and Agency enter into a memorandum of understanding, or other similar arrangement, under which the RHS agrees to notify the Agency of the inspection results.

(4) *Delegation.* An Agency may delegate inspection under this paragraph (d) to an Authorized Delegate retained under paragraph (f) of this section. Such Authorized Delegate, which may include HUD or a HUD-approved inspector, must notify the Agency of the inspection results.

(e) * * *

(3) * * *

(i) * * * If the noncompliance or failure to certify is corrected within 3 years after the end of the correction period, the Agency is required to file Form 8823 with the Service reporting the correction of the noncompliance or failure to certify.

* * * * *

(h) * * * In addition, the requirements in paragraphs (b)(3) and (c)(1)(v), (vi), and (xi) of this section (involving recordkeeping and annual owner certifications) and paragraphs (c)(2)(ii)(B), (c)(2)(iii), and (d) of this section (involving tenant file reviews and physical inspections of existing projects, and the physical inspection standard) are applicable January 1, 2001. The requirement in paragraph (c)(2)(ii)(A) of this section (involving tenant file reviews and physical inspections of new projects) is applicable for buildings placed in service on or after January 1, 2001. The requirements in paragraph (c)(5) of this section (involving Agency reporting of compliance monitoring activities to the Service) and paragraph (e)(3)(i) of this section (involving Agency reporting of corrected noncompliance or failure to certify within 3 years after the end of the correction period) are applicable January 14, 2000.

Par. 3. Section 1.42–6 is amended by:

1. In paragraph (c)(3), second sentence, remove the language "Annual Low-Income Housing Credit Agencies Report," and add the language " 'Annual Low-Income Housing Credit Agencies Report,' " in its place.

2. In paragraph (d)(1), first sentence, remove the language "Low-Income Housing Credit Allocation Certification," and add the language " 'Low-Income Housing Credit Allocation Certification,' " in its place.

3. Revising the first sentence in paragraph (d)(4)(ii).

§1.42–6 Buildings qualifying for carryover allocations.

* * * * *

(d) * * *

(4) * * *

(ii) *Agency.* The Agency must retain the original carryover allocation document made under paragraph (d)(2) of this section and file Schedule A (Form 8610), "Carryover Allocation of the Low-Income Housing Credit," with the Agency's Form 8610 for the year the allocation is made. * * *

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Par. 4. Section 1.42–11 is amended by revising the last sentence in paragraph (b)(3)(ii)(A) to read as follows:

§1.42–11 Provision of services.

* * * * *

(b) * * *

(3) * * *

(ii) * * * (A) * * * For a building described in section 42(i)(3)(B)(iii) (relating to transitional housing for the homeless) or section 42(i)(3)(B)(iv) (relating to single-room occupancy), a supportive service includes any service provided to assist tenants in locating and retaining permanent housing.

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Par. 5. Section 1.42–12 is amended by adding paragraph (c) to read as follows:

§1.42–12 Effective dates and transitional rules.

* * * * *

(c) *Carryover allocations.* The rule set forth in §1.42–6(d)(4)(ii) relating to the requirement that state and local housing agencies file Schedule A (Form 8610), "Carryover Allocation of the Low-Income Housing Credit," is applicable for carryover allocations made after December 31, 1999.

Par. 6. Section 1.42–13 is amended by:

1. Revising the introductory text of paragraph (b)(3)(iii).

2. Adding paragraphs (b)(3)(vi), (b)(3)(vii), and (b)(3)(viii).

3. Adding a sentence at the end of paragraph (d).

The revisions and additions read as follows:

§1.42–13 Rules necessary and appropriate; housing credit agencies' correction of administrative errors and omissions.

* * * * *

(b) * * *

(3) * * *

(iii) *Secretary's prior approval required.* Except as provided in paragraph (b)(3)(vi) of this section, an Agency must obtain the Secretary's prior approval to correct an administrative error or omission, as described in paragraph (b)(2) of this section, if the correction is not made before the close of the calendar year of the error or omission and the correction—

* * * * *

(vi) *Secretary's automatic approval.* The Secretary grants automatic approval to correct an administrative error or omission described in paragraph (b)(2) of this section if—

(A) The correction is not made before the close of the calendar year of the error or omission and the correction is a numerical change to the housing credit dollar amount allocated for the building or multiple-building project;

(B) The administrative error or omission resulted in an allocation document (the Form 8609, "Low-Income Housing Credit Allocation Certification," or the allocation document under the requirements of section 42(h)(1)(E) or (F), and §1.42–6(d)(2)) that either did not accurately reflect the number of buildings in a project (for example, an allocation document for a 10-building project only references 8 buildings instead of 10 buildings), or the correct information (other than the amount of credit allocated on the allocation document);

(C) The administrative error or omission does not affect the Agency's ranking of the building(s) or project and the total amount of credit the Agency allocated to the building(s) or project; and

(D) The Agency corrects the administrative error or omission by following the procedures described in paragraph (b)(3)(vii) of this section.

(vii) *How Agency corrects errors or omissions subject to automatic approval.* An Agency corrects an administrative error or omission described in paragraph (b)(3)(vi) of this section by—

(A) Amending the allocation document described in paragraph (b)(3)(vi)(B) of this section to correct the administrative error or omission. The Agency will indicate on the amended allocation document that it is making the "correction under §1.42–13(b)(3)(vii)." If correcting the allocation document requires including any additional B.I.N.(s) in the document, the document must include any B.I.N.(s) already existing for buildings in the project. If possible, the additional B.I.N.(s) should be sequentially numbered from the existing B.I.N.(s);

(B) Amending, if applicable, the Schedule A (Form 8610), "Carryover Allocation of the Low-Income Housing Credit," and attaching a copy of this schedule to Form 8610, "Annual Low-Income Housing Credit Agencies Report," for the year the correction is made. The Agency will indicate on the schedule that it is making the "correction under §1.42–13(b)(3)(vii)." For a carryover allocation made before January 1, 2000, the Agency must complete Schedule A (Form 8610), and indicate on the schedule that it is making the "correction under §1.42–13(b)(3)(vii)";

(C) Amending, if applicable, the Form 8609 and attaching the original of this amended form to Form 8610 for the year the correction is made. The Agency will indicate on the Form 8609 that it is making the "correction under §1.42–13(b)(3)(vii)"; and

(D) Mailing or otherwise delivering a copy of any amended allocation document and any amended Form 8609 to the affected taxpayer.

(viii) *Other approval procedures.* The Secretary may grant automatic approval to correct other administrative errors or omissions as designated in one or more documents published either in the **Federal Register** or in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

* * * * *

(d) * * * Paragraphs (b)(3)(vi), (vii), and (viii) of this section are effective January 14, 2000.

Par. 7. Section 1.42–17 is added to read as follows:

§1.42–17 Qualified allocation plan.

(a) *Requirements*—(1) *In general.* [Reserved]

(2) *Selection criteria.* [Reserved]

(3) *Agency evaluation.* Section 42(m)(2)(A) requires that the housing credit dollar amount allocated to a project is not to exceed the amount the Agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period. In making this determination, the Agency must consider—

(i) The sources and uses of funds and the total financing planned for the project. The taxpayer must certify to the Agency the full extent of all federal, state, and local subsidies that apply (or which the taxpayer expects to apply) to the project. The taxpayer must also certify to the Agency all other sources of funds and all development costs for the project. The taxpayer's certification should be sufficiently detailed to enable the Agency to ascertain the nature of the costs that will make up the total financing package, including subsidies and the anticipated syndication or placement proceeds to be raised. Development cost information, whether or not includible in eligible basis under section 42(d), that should be provided to the Agency includes, but is not limited to, site acquisition costs, construction contingency, general contractor's overhead and profit, architect's and engineer's fees, permit and survey fees, insurance premiums, real estate taxes during construction, title and recording fees, construction period interest, financing fees, organizational costs, rent-up and marketing costs, accounting and auditing costs, working capital and operating deficit reserves, syndication and legal fees, and developer fees;

(ii) Any proceeds or receipts expected to be generated by reason of tax benefits;

(iii) The percentage of the housing credit dollar amount used for project costs other than the costs of intermediaries. This requirement should not be applied so as to impede the development of projects in hard-to-develop areas under section 42(d)(5)(C); and

(iv) The reasonableness of the developmental and operational costs of the project.

(4) *Timing of Agency evaluation*—(i) *In general.* The financial determinations and certifications required under paragraph (a)(3) of this section must be made as of the following times—

(A) The time of the application for the housing credit dollar amount;

(B) The time of the allocation of the housing credit dollar amount; and

(C) The date the building is placed in service.

(ii) *Time limit for placed-in-service evaluation.* For purposes of paragraph (a)(4)(i)(C) of this section, the evaluation for when a building is placed in service must be made not later than the date the Agency issues the Form 8609, "Low-Income Housing Credit Allocation Certification." The Agency must evaluate all sources and uses of funds under paragraph (a)(3)(i) of this section paid, incurred, or committed by the taxpayer for the project up until date the Agency issues the Form 8609.

(5) *Special rule for final determinations and certifications.* For the Agency's evaluation under paragraph (a)(4)(i)(C) of this section, the taxpayer must submit a schedule of project costs. Such schedule is to be prepared on the method of accounting used by the taxpayer for federal income tax purposes, and must detail the project's total costs as well as those costs that may qualify for inclusion in eligible basis under section 42(d). For projects with more than 10 units, the schedule of project costs must be accompanied by a Certified Public Accountant's audit report on the schedule (an Agency may require an audited schedule of project costs for projects with fewer than 11 units). The CPA's audit must be conducted in accordance with generally accepted auditing standards. The auditor's report must be unqualified.

(6) *Bond-financed projects.* A project qualifying under section 42(h)(4) is not entitled to any credit unless the governmental unit that issued the bonds (or on behalf of which the bonds were issued), or the Agency responsible for issuing the Form(s) 8609 to the project, makes determinations under rules similar to the rules in paragraphs (a)(3), (4), and (5) of this section.

(b) *Effective date.* This section is ef-

fective January 1, 2001.

Part 602–OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In §602.101, paragraph (b) is amended by revising the entry for 1.42–5 and adding an entry for 1.42–17 to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.42–5	1545-1357
1.42–17	1545-1357

Robert E. Wenzel,
Acting Commissioner of Internal Revenue.

Approved December 28, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 13, 2000, 8:45 a.m., and published in the issue of the Federal Register for January 14, 2000, 65 F.R. 2323)