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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9587]

RIN 1545-BD20

Section 42 Qualified Contract Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations that provide guidance concerning taxpayers' (that is, owners') requests to housing credit agencies to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. Section 42(h)(6)(F) requires the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the provisions of section 42(h)(6)(F), including regulations to prevent the manipulation of the qualified contract amount. The regulations will affect owners requesting a qualified contract, potential buyers, and low-income housing credit agencies responsible for the administration of the low-income housing credit program.

DATES: Effective Date: These regulations are effective **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Date: For the applicability date, see §1.42-18(e).

FOR FURTHER INFORMATION CONTACT: David Selig at (202) 622-3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has 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(d)) under control number 1545-2088. The collection of information is required for an owner to provide a written request to a housing credit agency to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The collecting of information is voluntary to obtain a benefit.

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

Books or records relating to a collection of information must be retained as long as their contents might 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

This document contains final regulations that amend the Income Tax Regulations (26 CFR part 1) relating to the low-income housing credit under section 42 of the Internal Revenue Code (Code). On June 19, 2007, a notice of proposed rulemaking (REG-114084-04) and notice of public hearing relating to the qualified contract provisions under section 42(h)(6)(F) was published in the **Federal Register** (72 FR 33706). Written and electronic comments responding to the proposed regulations were

received and a public hearing was held on the proposed regulations on October 15, 2007. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision.

General Overview

Section 42 provides a tax credit for investment in low-income housing buildings placed in service after December 31, 1986. The section 42 credit is a general business credit subject to the provisions of section 38.

Section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of the taxable year.

Section 42(h)(6)(B) provides in part that the term commitment means any agreement between the owner and the housing credit agency (Agency) that requires that the applicable fraction (as defined in section 42(c)(1)(B)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the commitment. Section 42(h)(6)(E)(ii) prohibits the eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit or any increase in the gross rent with respect to such unit not otherwise permitted under section 42 until three years after the termination of such an agreement.

Section 42(h)(6)(D) defines the term extended use period as the period beginning on the first day in the compliance period (as defined in section 42(i)(1)) on which the building is part of a qualified low-income housing project and ending on the

later of: (1) the date specified by the Agency in the commitment, or (2) the date which is 15 years after the close of the compliance period.

Section 42(h)(6)(E)(i)(II) provides for the termination of the extended use period if the Agency is unable to present within a specified period of time a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building.

Section 42(h)(6)(F) defines the term qualified contract as a bona fide contract to acquire (within a reasonable period of time after the contract is entered into) the non low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the commitment) of the sum of: (I) the outstanding indebtedness secured by, or with respect to the building, (II) the adjusted investor equity in the building, plus (III) other capital contributions not reflected in these amounts; reduced by cash distributions from (or available for distribution from) the project.

Section 42(h)(6)(F) also provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out that paragraph, including regulations to prevent the manipulation of the amount determined under section 42(h)(6)(F).

Section 42(h)(6)(I) provides that the Agency must present the qualified contract within the 1-year period beginning on the date (after the 14th year of the compliance period) the owner submits a written request to the Agency to find a person to acquire the owner's interest in the low-income portion of the building.

The proposed regulations addressed the application of the qualified contract provisions of section 42. Section 1.42-18(c)(1) of the proposed regulations defined the

qualified contract formula used to compute the purchase price amount of the low-income housing building generally as: (1) the non low-income portion of the building for fair market value; plus (2) the low-income portion of the building for the low-income portion amount.

Section 1.42-18(c)(2) of the proposed regulations defined the low-income portion amount as an amount not less than the applicable fraction (as specified in the commitment) of the total of: (a) outstanding indebtedness secured by, or with respect to the building; plus (b) the adjusted investor equity in the building; plus (c) other capital contributions, not including amounts described in (a) and (b); minus (d) cash distributions from (or available for distribution from) the building.

Summary of Comments

Fair-Market-Value Cap

Prior to the issuance of the proposed regulations, comments were received recommending the inclusion of a fair-market-value cap for the low-income portion of the qualified contract amount as defined in section 42(h)(6)(F). These comments noted that the qualified contract price may, in some cases, exceed the fair market value of a project. One reason given to explain why the qualified contract price might exceed the fair market value of a project is the formula component for adjusted investor equity, which includes the Consumer-Price-Index-based cost of living adjustments. As explained in the preamble to the proposed regulations, this recommendation was not adopted as a proposed rule because section 42(h)(6)(F) defines a qualified contract, in part, as a contract to acquire the low-income portion of the building for an amount “not less than” the applicable fraction of the statutorily provided formula. Similar comments

were received after publication of the proposed regulations. The IRS and the Treasury Department continue to believe that they do not have the authority under section 42(h)(6)(F) to adopt a fair-market-value cap. Accordingly, the final regulations do not provide a rule providing a fair-market-value cap under section 42(h)(6)(F).

The IRS and the Treasury Department in the preamble to the proposed regulations requested comments on the extent of Agency and State authority to provide more stringent requirements than those contained in section 42(h)(6)(F). The preamble referenced the flush language of section 42(h)(6)(E)(i), which provides that the qualified contract exception to the termination of an extended use period shall not apply to the extent more stringent requirements are provided in the agreement or in State law. Specifically, the IRS and the Treasury Department requested comments on the authority of Agency or State regulators to require in agreements a fair-market-value cap that would restrict any qualified contract price to fair market value. In response, two comments were received, both opining that an Agency did not possess authority under section 42(h)(6)(E) to set a fair market value limitation. The commentators reasoned that the language “more stringent requirements” relates to the date the extended use period will terminate, rather than to the qualified contract formula. The IRS and Treasury Department received no comment asserting the view that section 42(h)(6)(E)(i) authorizes an Agency or State regulators to require in agreements a fair-market-value cap that would restrict a qualified contract price to fair market value. The IRS and Treasury Department do not believe that section 42(h)(6)(E)(i) was intended to authorize a fair-market-value cap on the low-income portion of the building, and, accordingly, the final regulations do not provide for such a cap.

Adjustments to Fair Market Value of the Non-Low-Income Portion of the Building

Some commentators questioned the provision in the proposed regulations that would allow Agencies to adjust the fair market value of a building, if, after a reasonable period of time within the one-year offer-of-sale period, no buyer has made an offer or market values have adjusted downward. One commentator noted that, as a result of this provision, in order to secure a more favorable price for the building, prospective buyers might wait out the qualified contract process until an Agency reduces the qualified contract price. Another commentator noted the unfairness of granting Agencies the unilateral right to reduce the fair market value of the non low-income portion of the building, particularly when the proposed regulations provide no limitation on how much the Agency may reduce the fair market value.

The IRS and the Treasury Department believe these concerns are valid. Accordingly, the final regulations revise this provision to provide that the Agency may adjust the fair market value of the non low-income portion of the building after the Agency's offer of sale of the building to the general public and before the close of the one-year offer of sale period only with the consent of the owner. If no agreement between the Agency and owner is reached, the fair market value of the non low-income portion of the building determined at the time of the Agency's offer of sale of the building to the general public remains unchanged.

Land

The proposed regulations provide that the fair market value of the non low-income portion of a building is determined at the time of an Agency's offer of sale of the building to the general public. This valuation must take into account the existing and

continuing requirements contained in the commitment for the building. The non low-income portion also includes the fair market value of the land underlying the entire building, including the land underlying the low-income portion of the building.

Commentators questioned the statutory authority of the IRS under section 42(h)(6)(F) to include land value in the qualified contract amount. Specifically, commentators noted that the language under section 42(h)(6)(F) refers to the fair market value of the non low-income portion of the building without addressing the issue of land valuation. Other commentators asserted that adopting a fair market value approach for land underlying the entire building may decrease the likelihood of finding a qualified buyer willing to pay the qualified contract price while continuing to operate the building as a low income building.

The IRS and the Treasury Department believe that land is inherently part of the cost underlying the acquisition or construction of a building and should not be ignored in determining the qualified contract amount. Applying fair market value to land is consistent with industry practice regarding land valuation and provides an equitable means for arriving at a contract price between buyers and owners. By valuing land underlying the entire building at fair market value, taking into account the existing and continuing requirements contained in the commitment for the building, the proposed regulations provided an approach that maintains industry practice for valuing land and provided an objective and equitable solution that favors neither the buyer nor the owner. Accordingly, the final regulations provide that the land underlying the entire building (both low-income and non low-income units) is valued at fair market value subject to the existing and continuing restrictions contained in the commitment for the building.

Responsibility to Adjust the Qualified Contract Price to Reflect the Changing Amount of Outstanding Indebtedness

One commentator expressed concern that the proposed regulations would impose too much burden on Agencies by requiring them to adjust the qualified contract amount between the date on which the sales price under a qualified contract is first determined and the sale's actual closing date. (For example, an adjustment is needed to reflect mortgage payments that reduce outstanding indebtedness.) The IRS and the Treasury Department concur with this comment, and the final regulations provide that the buyer and owner, and not the Agency, must adjust the amount of the low-income portion of the qualified contract formula to reflect changes in the components of the qualified contract formula, such as mortgage payments that reduce outstanding indebtedness between the time the Agency first offers the property for sale and the actual sale closing date.

Cash Distributions

One commentator recommended that the final regulations clarify that the rule in the proposed regulations providing that cash available for distribution includes reserve funds should apply only to the extent that the reserve funds are not legally required to remain with the project after the sale. Other commentators noted the potential for double-counting if cash available for distribution includes the proceeds from refinancing indebtedness or additional mortgages, while simultaneously any refinancing indebtedness or additional mortgages in excess of qualifying building costs are not outstanding indebtedness for purposes of section 42(h)(6)(F).

The IRS and the Treasury Department agree with these comments. Accordingly, the final regulations provide that cash available for distribution includes reserve funds that are not legally required by mortgage restrictions, regulatory agreements, or third party contractual agreements to remain with the building following the sale of the building. The final regulations further provide that proceeds from refinancing indebtedness or additional mortgages that are in excess of qualifying building costs are not considered cash available for distribution. The text of the final regulations also adopts the rule discussed in the preamble to the proposed regulations, but not stated in the text of the proposed regulations, that any refinancing indebtedness or additional mortgages in excess of qualifying building costs do not qualify as outstanding indebtedness for purposes of section 42(h)(6)(F).

Discounting Indebtedness Removed

Some commentators questioned the rationale for the requirement in the proposed regulations that would discount outstanding indebtedness having an interest rate below the applicable Federal rate (AFR) under section 1274 of the Code. In response, the final regulations remove the provision of discounting indebtedness altogether. Instead, the final regulations define outstanding indebtedness to include only those amounts secured by, or with respect to, the building that (1) do not exceed qualifying building costs, (2) are indebtedness under general principles of Federal income tax law, and (3) upon the sale of the building, are actually paid to the lender or are assumed by the buyer as part of the sale.

Appraiser Standards

Several commentators noted the absence of any uniform standards for appraisal methodology and qualifications for appraisers. Rather than adopt appraisal standards, the final regulations provide that Agencies shall not utilize any individual or organization as an appraiser if that individual or organization is currently on any list for active suspension or revocation for performing appraisals in any State or is listed on the Excluded Parties Lists System (EPLS) maintained by the General Services Administration for the United States Government. The final regulations also provide the Agencies with the discretion to select the appraisers involved in the qualified contract process and to require all appraisers to be State-certified general appraisers.

Actual Offer of Sale

The proposed regulations provide that in order to satisfy the qualified contract requirements under section 42(h)(6)(F), the Agency must offer the building for sale to the general public at the determined qualified contract price upon receipt of a written request by the owner to find a buyer to acquire the building. In addressing the issue of how Agencies should advertise the availability of a building to the general public, the final regulations provide a reasonable efforts standard for guiding Agencies in their efforts to find a qualified buyer during the one year offer period. If the determined qualified contract price is not a multiple of \$1,000, the final regulations permit the Agency to round up the offering price of the building to the next highest multiple of \$1,000.

Definition of Bona Fide Contract and Resolution of Disputes

Some commentators suggested the inclusion of a specific definition of a bona fide contract under section 42(h)(6)(F), addressing issues such as whether the terms and conditions of any offered contract are unreasonable or impractical. Further, commentators suggested the creation of a mechanism for resolving disputes among the parties concerning the meaning of a bona fide contract. The IRS and the Treasury Department believe that because of variations under State laws concerning the terms of a bona fide contract and methods for resolving disputes, the final regulations should not explicitly address these issues. Instead, the final regulations provide that an Agency has the administrative discretion to specify other conditions applicable to the qualified contract consistent with section 42 of the Code and the final regulations.

Adjusted Investor Equity

To avoid ambiguity in the determination of the qualified contract amount, the final regulations require adjusted investor equity to be calculated in a manner that is consistent with inflation adjustments made under section 1(f). Thus, as was required in the proposed regulations, the calculations must use not seasonally adjusted values of the Consumer Price Index for all urban consumers (the data series that the Bureau of Labor Statistics refers to as "CPI-U"). The final regulations provide a computational process that is mathematically equivalent to the process described in the proposed regulations but that will be simpler to implement. Because of the uncertainty that can be introduced when one number is divided by another and because different people might choose to retain in the answer different numbers of digits, the regulations require the quotient in this process to be carried out to 10 decimal places. (If standard, off-the-shelf

spreadsheet software is used to compute the adjusted investor equity, the computations will generally have at least this degree of accuracy by default.) In addition, the example in the final regulations has been updated to use more recent data. Finally, the final regulations make it possible for the Commissioner to reduce the computational burden by, for example, providing the possible adjustment factors in annual publications or creating a calculator on the IRS website.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. 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 collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. The information required to be provided by a taxpayer (that is, by the owner of a low-income building) to a State agency to determine the qualified contract amount is already maintained by the taxpayer for other purposes of the low-income tax credit under section 42. Because only a minimal amount of additional time is required for a taxpayer to access and provide the information, this collection of information does not impose a significant burden on the taxpayer. Accordingly, a Regulatory Flexibility Analysis under the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed regulations preceding these final regulations was

submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business, and no comments were received.

Drafting Information

The principal author of these regulations is David Selig of the Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

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 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 1.42-18 also issued under 26 U.S.C. 42(h)(6)(F) and 42(h)(6)(K); * * *

Par. 2. Section 1.42-18 is added to read as follows:

§1.42-18 Qualified contracts.

(a) Extended low-income housing commitment--(1) In general. No credit under section 42(a) is allowed by reason of section 42 with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as

defined in section 42(h)(6)(B)) is in effect as of the end of such taxable year. A commitment must be in effect for the extended use period (as defined in paragraph (a)(1)(i) of this section).

(i) Extended use period. The term extended use period means the period beginning on the first day in the compliance period (as defined in section 42(i)(1)) on which the building is part of a qualified low-income housing project (as defined in section 42(g)(1)) and ending on the later of--

(A) The date specified by the low-income housing credit agency (Agency) in the commitment; or

(B) The date that is 15 years after the close of the compliance period.

(ii) Termination of extended use period. The extended use period for any building will terminate--

(A) On the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Commissioner determines that such acquisition is part of an arrangement with the taxpayer ("the owner") a purpose of which is to terminate such period; or

(B) On the last day of the one-year period beginning on the date (after the 14th year of the compliance period) on which the owner submits a written request to the Agency to find a person to acquire the owner's interest in the low-income portion of the building if the Agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building (as defined in section 42(c)(2)).

(iii) Owner non-acceptance. If the Agency provides a qualified contract within the one-year period and the owner rejects or fails to act upon the contract, the building remains subject to the existing commitment.

(iv) Eviction, gross rent increase concerning existing low-income tenants not permitted. Prior to the close of the three year period following the termination of a commitment, no owner shall be permitted to evict or terminate the tenancy (other than for good cause) of an existing tenant of any low-income unit, or increase the gross rent for such unit in a manner or amount not otherwise permitted by section 42.

(2) Exception. Paragraph (a)(1)(ii)(B) of this section shall not apply to the extent more stringent requirements are provided in the commitment or under State law.

(b) Definitions. For purposes of this section, the following terms are defined:

(1) As provided by section 42(h)(6)(G)(iii), base calendar year means the calendar year with or within which the first taxable year of the credit period ends.

(2) The low-income portion of a building is the portion of the building equal to the applicable fraction (as defined in section 42(c)(1)(B)) specified in the commitment for the building.

(3) The fair market value of the non-low-income portion of the building is determined at the time of the Agency's offer of sale of the building to the general public. The fair market value of the non-low-income portion also includes the fair market value of the land underlying the entire building (both the non-low-income portion and the low-income portion). This valuation must take into account the existing and continuing requirements contained in the commitment for the building. The fair market value of the non-low-income portion also includes the fair market value of items of personal property

not included in eligible basis under section 42(d) that convey under the contract with the building.

(4) Qualifying building costs include--

(i) Costs that are included in eligible basis of a low-income housing building under section 42(d) and that are included in the adjusted basis of depreciable property that is subject to section 168 and that is residential rental property for purposes of section 142(d) and §1.103-8(b);

(ii) Costs that are included in eligible basis of a low-income housing building under section 42(d) and that are included in the adjusted basis of depreciable property that is subject to section 168 and that is used in a common area or is provided as a comparable amenity to all residential rental units in the building; and

(iii) Costs of the type described in paragraph (b)(4)(i) and (ii) of this section incurred after the first year of the low-income housing building's credit period under section 42(f).

(5) The qualified contract amount is the sum of the fair market value of the non-low-income portion of the building (within the meaning of section 42(h)(6)(F) and paragraph (b)(3) of this section) and the price for the low-income portion of the building (within the meaning of section 42(h)(6)(F) and paragraph (b)(2) of this section) as calculated in paragraph (c)(2) of this section. If this sum is not a multiple of \$1,000, then when the Agency offers the building for sale to the general public, the Agency may round up the offering price to the next highest multiple of \$1,000.

(c) Qualified contract purchase price formula--(1) In general. For purposes of this section, qualified contract means a bona fide contract to acquire the building (within a reasonable period after the contract is entered into) for the qualified contract amount.

(i) Initial determination. The qualified contract amount is determined at the time of the Agency's offer of sale of the building to the general public.

(ii) Mandatory adjustment by the buyer and owner. The buyer and owner under a qualified contract must adjust the amount of the low-income portion of the qualified contract formula to reflect changes in the components of the qualified contract formula such as mortgage payments that reduce outstanding indebtedness between the time of the Agency's offer of sale to the general public and the building's actual sale closing date.

(iii) Optional adjustment by the Agency and owner. The Agency and owner may agree to adjust the fair market value of the non low-income portion of the building after the Agency's offer of sale of the building to the general public and before the close of the one-year period described in paragraph (a)(1)(ii)(B) of this section. If no agreement between the Agency and owner is reached, the fair market value of the non-low-income portion of the building determined at the time of the Agency's offer of sale of the building to the general public remains unchanged.

(2) Low-income portion amount. The low-income portion amount is an amount not less than the applicable fraction specified in the commitment, as defined in section 42(h)(6)(B)(i), multiplied by the total of--

(i) The outstanding indebtedness for the building (as defined in paragraph (c)(3) of this section); plus

(ii) The adjusted investor equity in the building for the calendar year (as defined in paragraph (c)(4) of this section); plus

(iii) Other capital contributions (as defined in paragraph (c)(5) of this section), not including any amounts described in paragraphs (c)(2)(i) and (ii) of this section; minus

(iv) Cash distributions from (or available for distribution from) the building (as defined in paragraph (c)(6) of this section).

(3) Outstanding indebtedness. For purposes of paragraph (c)(2)(i) of this section, outstanding indebtedness means the remaining stated principal balance (which is initially determined at the time of the Agency's offer of sale of the building to the general public) of any indebtedness secured by, or with respect to, the building that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. Thus, any refinancing indebtedness or additional mortgages in excess of such qualifying building costs are not outstanding indebtedness for purposes of section 42(h)(6)(F) and this section. Examples of outstanding indebtedness include certain mortgages and developer fee notes (excluding developer service costs not included in eligible basis). Outstanding indebtedness does not include debt used to finance nondepreciable land costs, syndication costs, legal and accounting costs, and operating deficit payments. Outstanding indebtedness includes only obligations that are indebtedness under general principles of Federal income tax law and that are actually paid to the lender upon the sale of the building or are assumed by the buyer as part of the sale of the building.

(4) Adjusted investor equity—(i) Application of cost-of-living factor. For purposes of paragraph (c)(2)(ii) of this section, the adjusted investor equity for any calendar year

equals the unadjusted investor equity, as described in paragraph (c)(4)(ii) of this section, multiplied by the qualified-contract cost-of-living adjustment for that year, as defined in paragraph (c)(4)(iii) of this section.

(ii) Unadjusted investor equity. For purposes of this paragraph (c)(4), unadjusted investor equity means the aggregate amount of cash invested by owners for qualifying building costs described in paragraph (b)(4)(i) and (ii) of this section. Thus, equity paid for land, credit adjuster payments, Agency low-income housing credit application and allocation fees, operating deficit contributions, and legal, syndication, and accounting costs all are examples of cost payments that do not qualify as unadjusted investor equity. Unadjusted investor equity takes an amount into account only to the extent that, as of the beginning of the low-income building's credit period (as defined in section 42(f)(1)), there existed an obligation to invest the amount. Unadjusted investor equity does not include amounts included in the calculation of outstanding indebtedness as defined in paragraph (c)(3) of this section.

(iii) Qualified-contract cost-of-living adjustment. For purposes of this paragraph (c)(4), the qualified-contract cost-of-living adjustment for a calendar year is the number that is computed under the general rule in paragraph (c)(4)(iv) of this section or a number that may be provided by the Commissioner as described in paragraph (c)(4)(v) of this section.

(iv) General rule. Except as provided in paragraph (c)(4)(v) of this section, the qualified-contract cost-of-living adjustment is the quotient of—

(A) The sum of the 12 monthly Consumer Price Index (CPI) values whose average is the CPI for the calendar year that precedes the calendar year in which the

Agency offers the building for sale to the general public (The term “CPI for a calendar year” has the meaning given to it by section 1(f)(4) for purposes of computing annual inflation adjustments to the rate brackets.); divided by

(B) The sum of the 12 monthly CPI values whose average is the CPI for the base calendar year (within the meaning of section 1(f)(4)), unless that sum has been increased under paragraph (c)(4)(iii)(D) of this section.

(v) Provision by the Commissioner of the qualified-contract cost-of-living adjustment. The Commissioner may publish in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) a process pursuant to which the Internal Revenue Service will compute the qualified-contract cost-of-living adjustment for a calendar year and make available the results of that computation.

(vi) Methodology. The calculations in paragraph (c)(4)(iv) of this section are to be made in the following manner:

(A) The CPI data to be used for purposes of this paragraph (c)(4) are the not seasonally adjusted values of the CPI for all urban consumers. (The U.S. Department of Labor’s Bureau of Labor Statistics (BLS) sometimes refers to these values as “CPI–U.”) The BLS publishes the CPI data on-line (including a History Table that contains monthly CPI–U values for all years back to 1913). See www.BLS.gov/data.

(B) The quotient is to be carried out to 10 decimal places.

(C) The Agency may round adjusted investor equity to the nearest dollar.

(D) If the CPI for any calendar year (within the meaning of section 1(f)(4)) during the extended use period after the base calendar year exceeds by more than 5 percent the CPI for the preceding calendar year (within the meaning of section 1(f)(4)), then the

sum described in paragraph (c)(4)(i)(B) is to be increased so that the excess is never taken into account under this paragraph (c)(4).

(vii) Example. The following example illustrates the calculations described in this paragraph (c)(4):

Example. (i) Facts. Owner contributed \$20,000,000 in equity to a building in 1997, which was the first year of the credit period for the building. In 2011, Owner requested Agency to find a buyer to purchase the building, and Agency offered the building for sale to the general public during 2011. The CPI for 1997 (within the meaning of section 1(f)(4)) is the average of the Consumer Price Index as of the close of the 12-month period ending on August 31, 1997. The sum of the CPI values for the twelve months from September 1996 through August 1997 is 1913.9. The CPI for 2010 (within the meaning of section 1(f)(4)) is the average of the Consumer Price Index as of the close of the 12-month period ending August 31, 2010. The sum of the CPI values for the twelve months from September 2009 through August 2010 is 2605.959. At no time during this period (after the base calendar year) did the CPI for any calendar year exceed the CPI for the preceding calendar year by more than 5 percent.

(ii) Determination of adjusted investor equity. The qualified-contract cost-of-living adjustment is 1.3615962171 (the quotient of 2605.959, divided by 1913.9). Owner's adjusted investor equity, therefore, is \$27,231,924, which is \$20,000,000, multiplied by 1.3615962171, rounded to the nearest dollar.

(5) Other capital contributions. For purposes of paragraph (c)(2)(iii) of this section, other capital contributions to a low-income building are qualifying building costs described in paragraph (b)(4)(ii) of this section paid or incurred by the owner of the low-income building other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this section. For example, other capital contributions may include amounts incurred to replace a furnace after the first year of a low-income housing credit building's credit period under section 42(f), provided any loan used to finance the replacement of the furnace is not secured by the furnace or the building. Other capital contributions do not include expenditures for land costs, operating deficit payments, credit adjuster payments, and payments for legal, syndication, and accounting costs.

(6) Cash distributions--(i) In general. For purposes of paragraph (c)(2)(iv) of this section, the term cash distributions from (or available for distribution from) the building include--

(A) All distributions from the building to the owners or to persons whose relationship to the owner is described in section 267(b) or section 707(b)(1)), including distributions under section 301 (relating to distributions by a corporation), section 731 (relating to distributions by a partnership), or section 1368 (relating to distributions by an S corporation); and

(B) All cash and cash equivalents available for distribution at, or before, the time of sale, including, for example, reserve funds whether operating or replacement reserves, unless the reserve funds are legally required by mortgage restrictions, regulatory agreements, or third party contractual agreements to remain with the building following the sale.

(ii) Excess proceeds. For purposes of paragraph (c)(6)(i) of this section, proceeds from the refinancing of indebtedness or additional mortgages that are in excess of qualifying building costs are not considered cash available for distribution.

(iii) Anti-abuse rule. The Commissioner will interpret and apply the rules in this paragraph (c)(6) as necessary and appropriate to prevent manipulation of the qualified contract amount. For example, cash distributions include payments to owners or persons whose relation to owners is described in section 267(b) or section 707(b) for any operating expenses in excess of amounts reasonable under the circumstances.

(d) Administrative discretion and responsibilities of the Agency--(1) In general. An Agency may exercise administrative discretion in evaluating and acting upon an

owner's request to find a buyer to acquire the building. An Agency may establish reasonable requirements for written requests and may determine whether failure to follow one or more applicable requirements automatically prevents a purported written request from beginning the one-year period described in section 42(h)(6)(I). If the one-year-period has already begun, the Agency may determine whether failure to follow one or more requirements suspends the running of that period. Examples of Agency administrative discretion include, but are not limited to, the following:

(i) Concluding that the owner's request lacks essential information and denying the request until such information is provided.

(ii) Refusing to consider an owner's representations without substantiating documentation verified with the Agency's records.

(iii) Determining how many, if any, subsequent requests to find a buyer may be submitted if the owner has previously submitted a request for a qualified contract and then rejected or failed to act upon a qualified contract presented by the Agency.

(iv) Assessing and charging the owner certain administrative fees for the performance of services in obtaining a qualified contract (for example, real estate appraiser costs).

(v) Requiring all appraisers involved in the qualified contract process to be State certified general appraisers that are acceptable to the Agency.

(vi) Specifying other conditions applicable to the qualified contract consistent with section 42 and this section.

(2) Actual offer. Upon receipt of a written request from the owner to find a person to acquire the building, the Agency must offer the building for sale to the general public,

based on reasonable efforts, at the determined qualified contract amount in order for the qualified contract to satisfy the requirements of this section unless the Agency has already identified a willing buyer who submitted a qualified contract to purchase the project.

(3) Debarment of certain appraisers. Agencies shall not utilize any individual or organization as an appraiser if that individual or organization is currently on any list for active suspension or revocation for performing appraisals in any State or is listed on the Excluded Parties Lists System (EPLS) maintained by the General Services Administration for the United States Government found at www.epls.gov.

(e) Effective date/applicability date. These regulations are applicable to owner requests to housing credit agencies on or after **INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER** to obtain a qualified contract for the acquisition of a low-income housing credit building.

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.

Par. 4. In §602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read, in part, as follows:

§602.101 OMB Control numbers.

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(b) * * *

CFR part or section where identified and described	Current OMB control No.
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1.42-18	1545-2088
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Steven T. Miller

Deputy Commissioner for Services and Enforcement.

Approved: April 24, 2012

Emily S. McMahon
Acting Assistant Secretary of the Treasury (Tax Policy).

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