

Part III - Administrative, Procedural and Miscellaneous

American Recovery and Reinvestment Tax Act of 2009 Clarifications

Notice 2010-18

This Notice clarifies certain issues under sections 1404 and 1602 of the American Recovery and Reinvestment Tax Act of 2009 (Pub. L. 111-5) (the Act). Specifically, this Notice provides guidance on how to take into account the amount of a grant under section 1602 of the Act in reducing the amount of a state's housing credit ceiling, on the exclusion of the amount of grants from the recipients' gross income, and on the effect of such grants on the depreciable or eligible basis of property.

BACKGROUND

Section 42 of the Internal Revenue Code allows a 10-year tax credit for investment in qualified low-income buildings placed in service after December 31, 1986. Section 42(h)(1) provides, generally, that the amount of credit under § 42 for any taxable year for any building shall not exceed the housing credit dollar amount allocated to the building. Section 42(h)(3)(A) provides, in part, that the aggregate housing credit dollar amount that a State housing credit agency may allocate for any calendar year is limited to that year's State housing credit ceiling (Ceiling).

Section 42(h)(3)(C) of the Code provides, in part, that the Ceiling applicable to any State for any calendar year is an amount equal to--

- (i) the unused Ceiling, if any, of the State for the preceding calendar year;
- (ii) the greater of (I) \$1.75 multiplied by the State population, or (II) \$2,000,000;
- (iii) the amount of Ceiling returned in the calendar year, and;
- (iv) the amount, if any, allocated to the State by the Secretary under § 42(h)(3)(D) from a national pool (National Pool) of unused credit.

Section 42(h)(3)(H) of the Code provides that for calendar years after 2002, the \$2,000,000 and \$1.75 amounts in § 42(h)(3)(C)(ii) shall be increased by a cost-of-living adjustment (COLA). Section 42(h)(3)(I) increases the Ceiling for 2009 by adding (i) \$0.20 for the dollar amount in effect under § 42(h)(3)(C)(ii)(I) after application of the § 42(h)(3)(H) COLA, and (ii) an amount equal to 10 percent for the dollar amount in effect under § 42(h)(3)(C)(ii)(II) (rounded to the next lowest multiple of \$5,000) after application of the § 42(h)(3)(H) COLA. For the 2009 Ceiling, the § 42(h)(3)(C)(ii)(I) and (II) amounts are \$2.30 and \$2,665,000, respectively. See Section 3.07 of Rev. Proc. 2008-66, 2008-45 I.R.B. 1107, 1111.

Section 42(i)(9)(A) of the Code, as added by section 1404 of the Act, provides that the amounts described in § 42(h)(3)(C)(i) through (iv) with respect to any State for 2009 shall each be reduced by so much of the amount as is taken into account in determining the amount of any grant to the State under section 1602 of the Act. Section 1602(a) of the Act provides that the Department of the Treasury shall make a grant to the housing credit agency of each State in an amount equal to the State's low-income housing grant election amount. Section 1602(b) of the Act provides that the

term “low-income housing grant election amount” means, for any State, the amount as the State may elect that does not exceed 85 percent of—

(1) the sum of—

(A) 100 percent of the State’s 2009 Ceiling that is attributable to amounts described in § 42(h)(3)(C)(i) and (iii) of the Code, and

(B) 40 percent of the State’s 2009 Ceiling that is attributable to amounts described in § 42(h)(3)(C)(ii) and (iv), multiplied by

(2) 10.

On May 4, 2009, the Department of the Treasury released guidance in the form of an application (Application) and grantee terms and conditions (Terms and Conditions) informing designated State housing credit agencies (Designated Agencies) how to exchange low-income housing tax credits for amounts under section 1602 of the Act.

This guidance may be accessed electronically at:

http://www.treas.gov/recovery/docs/LIH_application-package.pdf

A list of the Designated Agencies is provided, and background information to the Application states, on page 3, that a Designated Agency is one that files Form 8610, “Annual Low-Income Housing Credit Agencies Report,” for all agencies within the State. Paragraph 2.a. of the Terms and Conditions provides that the grantee is the housing credit agency that files Form 8610. Paragraph 7.a. of the Terms and Conditions provides that the grantee shall track (1) the credit equivalent of all grant election amounts to ensure that the 2009 Ceiling is appropriately reduced as required by § 42(i)(9)(A) of the Code and (2) total grant election amounts to ensure that these

amounts do not exceed the amount authorized by section 1602(b) of the Act.

Paragraph 7.b. provides that the grantee shall track the total of credits allocated under § 42(h)(1). Paragraph 7.c. provides that the grantee shall ensure that the credit equivalent of all elected grant amounts through 2010, plus the credits allocated under § 42(h)(1) during 2009, do not exceed the 2009 Ceiling. The Terms and Conditions do not explain how the credit equivalent of a grant election amount is determined.

Section 42(d)(1) of the Code provides that the eligible basis of a new building is its adjusted basis as of the close of the first tax year of the credit period. Section 42(d)(4)(A) provides that, except as provided in § 42(d)(4)(B) and (C), the adjusted basis of any building is determined without regard to the adjusted basis of any property that is not residential rental property. Section 42(d)(4)(B) provides that the adjusted basis of any building includes the adjusted basis of property of a character subject to the allowance for depreciation used in common areas or provided as comparable amenities to all residential rental units in the building. Section 42(d)(5)(A) provides that the eligible basis of a building shall not include any costs financed with the proceeds of a federally funded grant. Section 42(i)(9)(B), as added by section 1404 of the Act, provides that the basis of a qualified building shall not be reduced by the amount of any grant described in § 42(i)(9)(A). The legislative history to the Act provides that grants received under this provision (i.e., cash assistance received under section 1602 of the Act) do not reduce [the] tax basis of a qualified low-income building. The legislative history to the Act further provides that grants under this provision are not taxable

income to recipients. See H.R. Conf. Rep. No. 16, 111th Cong., 1st Sess. 532, 533 (2009).

CLARIFICATIONS

1. Credit Equivalent of Cash Assistance and Tracking under § 42(i)(9)(A)

Section 42(i)(9)(A) of the Code, as added by section 1404 of the Act, requires that the amounts in § 42(h)(3)(C)(i) through (iv) shall each be reduced by so much of such amount as is taken into account in determining the amount of any grant (cash assistance) under section 1602 of the Act. Thus, similar to the way the Designated Agency tracks allocations of credit during the course of a calendar year to ensure that total credits allocated do not exceed the Ceiling for that year, § 42(i)(9)(A) implies a duty (and paragraph 7 of the grant application Terms and Conditions imposes a duty) by the Designated Agency to track credits allocated and the credit equivalent of cash assistance amounts to ensure that total credits allocated from the 2009 Ceiling and the credit equivalent of total cash assistance amounts do not exceed the 2009 Ceiling. A Designated Agency may determine the credit equivalent of a cash assistance amount by dividing the cash assistance amount by 8.5 and rounding the result up to the nearest dollar.

For example, in computing the reduction with respect to the § 42(h)(3)(C)(ii) component of the Ceiling (and using an actual figure published by the Department of the Treasury in the List of Designated Agencies attached to the Application), assume that the maximum cash assistance amount permissible from the 2009 Ceiling for State X with respect to that component is \$9,061,000. State X is a state whose population

qualifies for \$2,665,000 in credits under § 42(h)(3)(C)(ii)(II), as adjusted for inflation under § 42(h)(3)(H). The Department of the Treasury determined the maximum cash assistance amount of \$9,061,000 available to State X by multiplying total available credits of \$2,665,000 under § 42(h)(3)(C)(ii)(II) by the formula prescribed by section 1602(b) of the Act for credits under § 42(h)(3)(C)(ii)(II) (i.e., $0.85 \times ([\$2,665,000 \times 0.4] \times 10)$). Of this amount, assume the Designated Agency of State X elects under section 1602(b) of the Act a cash assistance amount of \$5 million. The credit equivalent of \$5 million is \$588,236 (i.e., $\$5 \text{ million} / 8.5 = \$588,235.29$, rounded up to the nearest dollar). For purposes of making the reduction required by § 42(i)(9)(A) to State X's 2009 Ceiling, the \$2,665,000 in credits under § 42(h)(3)(C)(ii) must be reduced by \$588,236, the credit equivalent of the \$5 million cash assistance amount, not by the \$5 million cash assistance amount. The \$2,076,764 (i.e., $\$2,665,000 - \$588,236$) remaining in credit under § 42(h)(3)(C)(ii) is available for use in making credit allocations by the Designated Agency. However, for purposes of making any future cash assistance election under section 1602 of the Act from the § 42(h)(3)(C)(ii) portion of State X's 2009 Ceiling, the \$9,061,000 maximum cash assistance amount is reduced by \$5 million to \$4,061,000.

The Department of the Treasury may not, in view of the taxpayer privacy and disclosure rules under § 6103 of the Code, publish the maximum cash assistance amounts from the other components of a State's 2009 Ceiling (unlike credits under § 42(h)(3)(C)(ii)). To ensure that credits allocated and the credit equivalent of cash assistance amounts from any of these components of the 2009 Ceiling do not exceed

credits available from those components, a Designated Agency should multiply the credit amount used to elect a cash assistance amount by the percentage applicable to that credit amount under section 1602(b)(1) of the Act, and then reduce the 2009 Ceiling accordingly.

For example, in computing the reduction with respect to the § 42(h)(3)(C)(iv) component of the Ceiling, assume that the credit amount of that component from State X's 2009 Ceiling is \$1 million. Assume further that in computing the reduction with respect to the § 42(h)(3)(C)(iii) component, the credit amount of that component from State X's 2009 Ceiling is \$2 million. Of the \$1 million in credits under § 42(h)(3)(C)(iv), the Designated Agency of State X elects under section 1602 of the Act to use \$800,000 for a cash assistance amount. Of the \$2 million in credits under § 42(h)(3)(C)(iii), the Designated Agency elects under section 1602 of the Act to use \$1.5 million for a cash assistance amount.

Under section 1602(b)(1)(B) of the Act, the percentage applicable to credit amounts under § 42(h)(3)(C)(iv) is 40 percent. The product of \$800,000 and 40 percent is \$320,000. As required by § 42(i)(9)(A), the \$1 million of credits under § 42(h)(3)(C)(iv) is reduced by \$320,000, not \$800,000. The remaining \$680,000 in credits (i.e., \$1 million - \$320,000) under § 42(h)(3)(C)(iv) is available for use in making credit allocations by the Designated Agency. However, the \$1 million of credit under § 42(h)(3)(C)(iv) is reduced by \$800,000 for purposes of making any future elections for cash assistance under section 1602 of the Act.

Under section 1602(b)(1)(A) of the Act, the percentage applicable to credit amounts under § 42(h)(3)(C)(iii) is 100 percent. The product of \$1.5 million and 100 percent is \$1.5 million. As required by § 42(i)(9)(A), the \$2 million of credits under § 42(h)(3)(C)(iii) is reduced by \$1.5 million, the actual credit amount elected by the Designated Agency to make a cash assistance election under section 1602 of the Act. The remaining \$500,000 in credits (i.e., \$2 million - \$1.5 million) under § 42(h)(3)(C)(iii) is available for use in making credit allocations by the Designated Agency. Similarly, the \$2 million in credits under § 42(h)(3)(C)(iii) is reduced by \$1.5 million for purposes of making any future elections for cash assistance under section 1602 of the Act.

2. Income Tax Treatment of Subawards

Based on the legislative history of the Act, subawards made pursuant to section 1602(c) of the Act are excluded from the gross income of recipients and are exempt from taxation.

3. Basis Treatment of Subawards

Section 42(i)(9)(B) of the Code, as added by section 1404 of the Act, provides that the basis of a qualified building shall not be reduced by the amount of any grant described in § 42(i)(9)(A). The legislative history to the Act provides that grants received under this provision (i.e., cash assistance received under section 1602 of the Act) do not reduce the tax basis of a qualified low-income building. By extension, subawards under section 1602(c) of the Act derived from cash assistance under that section that are used in a qualified low-income building are not federal grants for

purposes of § 42(d)(5)(A) and do not otherwise reduce the depreciable or eligible basis of the building.

DRAFTING INFORMATION

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