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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-123027-19]

RIN 1545-BP59

Section 42, Low-Income Housing Credit Compliance-Monitoring Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the compliance-monitoring duties of State or local housing credit agencies (Agencies) for purposes of the low-income housing credit under section 42 of the Internal Revenue Code (Code). These proposed regulations would relax the minimum compliance-monitoring sampling requirement for purposes of physical inspections and low-income certification review provided in the Amendments to the Low-Income Housing Credit Compliance-Monitoring Regulations (T.D. 9848) published in the **Federal Register** (84 FR 6076). The proposed regulations will affect owners of low-income housing projects, tenants in those low-income housing projects, and Agencies that administer the credit.

**DATES:** Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

**ADDRESSES:** Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-123027-19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

Send paper submissions to: CC:PA:LPD:PR (REG-123027-19), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Dillon Taylor or Michael J. Torruella Costa at (202) 317-4137; concerning submissions of comments and/or requests for a public hearing, Regina Johnson, (202) 317-5177 (not toll-free numbers).

## **SUPPLEMENTARY INFORMATION:**

### **Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 42 of the Code.

Section 42(m)(1) requires an Agency to allocate housing credit dollar amounts (the potential to earn low-income housing credits) among candidate proposed

buildings/projects. The allocation must be pursuant to a qualified allocation plan (QAP) that has been approved by the governmental unit of which the Agency is a part. A QAP not only sets forth selection criteria by which an Agency makes these allocations but also provides a procedure that the Agency must follow in monitoring for noncompliance with the provisions of section 42, including monitoring for noncompliance with habitability standards through regular site visits.

Section 1.42-5 of the Income Tax Regulations (the compliance-monitoring regulations) provides the requirements of a monitoring procedure that must be part of any QAP. Among the requirements, an Agency must perform physical inspections and low-income certification review.

The compliance-monitoring regulations, however, do not require that every low-income unit in a project be monitored for non-compliance. Instead, Agencies are permitted to satisfy their compliance-monitoring duties by physically inspecting, and performing low-income certification review, on only samples of those units. See T.D. 8430, 57 FR 40118, 40121 (Sept. 2, 1992).<sup>1</sup> For many years, starting in 2000, the minimum sample size for both file review and on-site inspections was 20 percent of the low-income units, regardless of the size of the total population of low-income units in a project. See TD 8859, 65 FR 2323, 2327 (Jan. 14, 2000).

On February 25, 2016, the Treasury Department and the IRS published temporary regulations (T.D. 9753) in the **Federal Register** (81 FR 9333), which

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<sup>1</sup> Initially, the requirements were that the Agency choose which units receive low-income certification review, that the owner receive no more than reasonable notice of the review, and that the Agency have the right to perform on-site inspection. See TD 8430 at 40122-23. Subsequently, some on-site inspections were required, and samples for both review and inspection were required to be chosen randomly. See TD 8859, 65 FR 2323, 2327 (Jan. 14, 2000).

amended §1.42-5 of the Income Tax Regulations and permitted the IRS to establish sample-size criteria in guidance published in the Internal Revenue Bulletin. See §601.601(d)(2)(ii)(b) of 26 CFR Chapter 1.<sup>2</sup> Concurrently with the issuance of the temporary regulations, Revenue Procedure 2016-15, 2016-11 I.R.B. 435, was published in the Internal Revenue Bulletin. This revenue procedure permitted an Agency to elect to use sample sizes of either a minimum of 20 percent of the low-income units in a project (rounded up to the nearest whole number) or the number in a chart identifying minimum sample sizes depending on the number of low-income units in a project (the Low-Income Housing Credit Minimum Unit Sample Size Reference Chart). The minimum sample sizes in the chart correspond to the minimum sample sizes required by the Department of Housing and Urban Development's (HUD's) Real Estate Assessment Center for inspections under HUD programs (the REAC numbers). HUD designed this table of sample sizes to produce a statistically consistent level of confidence in the results of physical inspections across a broad range of project sizes.

The revenue procedure had the effect of reducing the minimum sample sizes for large low-income housing projects (those with more than 110 low-income units). Because of the choice between using the REAC number and 20 percent of the low-income units, the revenue procedure did not impact projects with fewer than 111 low-income units.

The same sample-size provisions applied to independently selected samples on which the Agency must perform low-income certification review. The revenue

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<sup>2</sup> Also in the same issue of the **Federal Register**, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-150349-12, 81 FR 9379) (proposed regulations). The text of the proposed regulations incorporated by cross-reference the text of the temporary regulations.

procedure provided only minimum sample sizes, permitting Agencies to monitor compliance in more units, if desired.

In the preamble to the temporary regulations, the Treasury Department and the IRS expressed concern that, in smaller projects, physical inspection or low-income certification review of only 20 percent of the units might fail to produce sufficiently accurate estimates of the remaining units' overall compliance with habitability and low-income certification. To address this concern, the preamble added that "the Treasury Department and the IRS intend to consider whether Rev. Proc. 2016–15 should be replaced with a revenue procedure that does not permit use of the 20 percent rule in those circumstances." 81 FR at 9334. The removal of the 20 percent option would generally increase the number of units that needed to be inspected in smaller projects. The public comments on the temporary regulations directed very little attention to this potential increase.

In addition, the preamble invited fundamental suggestions to make inspections less burdensome:

The Treasury Department and the IRS believe the methods in Rev. Proc. 2016-15 reasonably balance the burden on Agencies, tenants, and building owners while adequately monitoring compliance. However, additional comments may be submitted on other possible methods, including stratified sampling procedures and estimation methodologies. To be useful, any such comments should include substantial detail regarding the procedures to be adopted and should provide thorough justification as to whether the suggested methods effectively reduce burden without negatively impacting the confidence that can be placed in the results obtained from the resulting samples.

*Id.* at 9336. The public submitted no comment letters specifically responsive to this request.

On February 26, 2019, the Treasury Department and IRS published regulations (T.D. 9848) in the **Federal Register** (84 FR 6076), finalizing the temporary regulations.

Because these final regulations contain provisions directly addressing all issues previously addressed in Revenue Procedure 2016-15, the preamble of the final regulations declares that revenue procedure obsolete with respect to an Agency as of the date on which the Agency's QAP is amended to reflect the final regulations and, in all cases, after December 31, 2020. See 84 FR at 6078. Among other provisions, the final regulations require Agencies to inspect no fewer units than the number specified for projects of the relevant size in the REAC numbers. This requirement has the effect of increasing the sample sizes for smaller projects. The Treasury Department and the IRS determined that the REAC numbers produce a statistically valid sampling of units and that using them yielded a consistent level of confidence in the compliance-monitoring results for projects of various sizes. The final regulations allow Agencies a reasonable period of time to amend their QAPs for this purpose, but require QAPs to be amended no later than December 31, 2020.

Since the publication of the final regulations, the Treasury Department and the IRS have received numerous oral and written comments from Agencies, stakeholders, and trade groups representing Agencies. In particular, these comments expressed concern that the final regulations ended Agencies' ability to use samples of 20 percent of the low-income units in a project when the applicable REAC number is larger. Consistent with the comments and letters, the trade groups' comment letters expressed concern about the situations in which the REAC numbers would increase the number of units that Agencies must examine, thereby increasing Agencies' costs for additional staff and other related expenditures and burdens. One trade group further explained that many Agencies would encounter difficulty in addressing increased staffing needs

and other new costs due to overall State budget constraints. The trade group observed that cost increases are also likely to cause Agencies to increase the compliance-monitoring fees that they charge to building owners. If fees are not increased enough to cover the increased costs, Agencies will have to divert resources from other affordable housing priorities to fund their compliance-monitoring activities. The trade group noted that terminating the ability to use the 20 percent samples will have its most significant impact on States with numerous small projects, predominantly in rural areas, and that some States with only small projects may even experience a 100 percent increase in burden.

### **Explanation of Provisions**

The final regulations reflected the belief of the Treasury Department and the IRS that a higher compliance-monitoring burden on Agencies was justified by the increased statistical confidence that results from the use of the REAC numbers to determine sample sizes for smaller projects. The comments on the final regulations, however, have demonstrated the magnitude of the increased costs and burdens that this requirement imposes on Agencies. As a result of these comments, the Treasury Department and the IRS have greater awareness of the many practical challenges Agencies experience in using samples greater than 20 percent while carrying out their compliance-monitoring responsibilities. Furthermore, the comments noted that many Agencies typically evaluate each project to determine if circumstances warrant the inspection and review of more units than the required minimum. Complying with the REAC numbers when an Agency believes that smaller samples would be sufficient may have the effect of depriving the Agency of the resources that it requires to engage in

additional compliance-monitoring activities on projects that manifest the need for inspection and review of more than the minimum sample of units.

Although there is value in providing a level of confidence that is more consistent over a broad range of project sizes, that increased consistency is outweighed in this context by concerns over Agencies' compliance-monitoring burdens. One goal of the compliance-monitoring regulations is to increase flexibility and reduce burden, so that Agencies may fulfill their compliance-monitoring responsibilities in an efficient and cost-effective manner. Accordingly, the Treasury Department and the IRS propose returning to the sample-size requirements that applied under the temporary regulations. Thus, under these proposed regulations, the minimum number of low-income units that must be included in the random samples on which an Agency conducts physical inspections or low-income certification review is the lesser of the applicable REAC number or 20 percent of the low-income units in the project, rounded up to the next whole number.

### **Proposed Applicability Date**

These regulations are proposed to apply beginning after the date these regulations are published as final regulations in the **Federal Register**. However, an Agency may rely on these proposed regulations beginning on February 26, 2019, until December 31 of the calendar year following the year that contains the date these regulations are published as final regulations in the **Federal Register**.

### **Special Analyses**

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the



Treasury Department and the Office of Management and Budget regarding review of tax regulations.

In accordance with the Regulatory Flexibility Act (5 U.S.C. chapter 6) it is hereby certified that these regulations will not impose a significant economic impact on a substantial number of small entities. These regulations reinstate the minimum compliance-monitoring sampling requirement for purposes of physical inspections and low-income certification review previously provided under the temporary regulations (T.D. 9753) published in the **Federal Register** (81 FR 9333) on February 25, 2016. These previously provided requirements had been and continue to be relied upon by Agencies since 2016.

Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### **Comments and Requests for a Public Hearing**

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the “**ADDRESSES**” section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the

date and time for the public hearing will be published in the **Federal Register**.

Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

### **Drafting Information**

The principal authors of these regulations are Dillon Taylor and Michael J. Torruella Costa, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### **PART 1--INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

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

Section 1.42-5 also issued under 26 U.S.C. 42(n). \* \* \*

\* \* \* \* \*

**Par. 2.** Amend §1.42-5 by revising paragraphs (c)(2)(iii)(B) and (h) to read as follows:

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

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iii) \* \* \*

(B) Number of low-income units. The minimum number of low-income units for which the Agency must conduct on-site inspections and low-income certification review is the lesser of—

(1) 20 percent of the low-income units in the low-income housing project, rounded up to the nearest whole number of units; or

(2) the Minimum Unit Sample Size set forth in the following Low-Income Housing Credit Minimum Unit Sample Size Reference Chart:

Table to Paragraph (c)(2)(iii)

Number of Low-Income Units in the Low-Income Housing Project	Number of Low-income Units Selected for Inspection or for Low-Income Certification Review (Minimum Unit Sample Size)
1	1
2	2
3	3
4	4
5-6	5
7	6
8-9	7
10-11	8
12-13	9
14-16	10
17-18	11
19-21	12
22-25	13
26-29	14
30-34	15
35-40	16
41-47	17
48-56	18
57-67	19
68-81	20
82-101	21
102-130	22
131-175	23
176-257	24
258-449	25
450-1,461	26
1,462-9,999	27

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(h) Applicability dates. The requirements in paragraph (c)(2)(iii)(B) of this section apply beginning after the date final regulations are published in the **Federal Register**.

\* \* \* \* \*

Douglas W. O'Donnell,  
Acting Deputy Commissioner for Services and Enforcement.