Part I

Section 42. - Low-Income Housing Credit.

(Also §§ 141, 142, and 146, and 26 CFR 1.42-8, 1.42-13, and 1.150-1).

# Rev. Rul. 2021-20

## ISSUES

(1) Does the minimum 4 percent applicable percentage (4 percent floor) under § 42(b)(3) of the Internal Revenue Code (Code) apply to the building in Situation 1, which is financed in part with a draw-down exempt facility bond issue that was issued in 2020 and on which one or more draws are taken after December 31, 2020?

(2) Does the 4 percent floor under § 42(b)(3) of the Code apply to the building in Situation 2, which is financed in part with proceeds of an exempt facility bond issue that was issued in 2020 and in part with proceeds of a different exempt facility bond issue that is issued in a *de minimis* amount after December 31, 2020?

(3) Does the 4 percent floor under § 42(b)(3) of the Code apply to the building in Situation 3, which receives an allocation of housing credit dollar amount in 2020 and a *de minimis* additional allocation after December 31, 2020?

FACTS

Situation 1: Draw-down loan with issue date in 2020. Agency is a State agency with authority to issue exempt facility bonds to support qualified residential rental projects within the meaning of § 142(d) of the Code. Taxpayer X (Conduit Borrower[1]) and Agency entered into an agreement that Agency would provide exempt facility bond financing to the Conduit Borrower to construct a new building for a qualified residential rental project. In 2020, Agency borrowed pursuant to a draw-down loan that qualifies as an issue of exempt facility bonds (the Loan), and the proceeds of the Loan are to be used by the Conduit Borrower to construct the building. Agency plans to make multiple draws under the Loan over the course of the construction, depending on the Conduit Borrower's financing needs at the time. In 2020, Agency drew an amount under the Loan that exceeded the lesser of $50,000 or 5 percent of the issue price. In subsequent years, Agency draws, and the Conduit Borrower uses, the remaining amounts available under the issue to construct the building. All of the draws on the Loan (that is, the bonds of the issue) are taken into account in applying the volume cap for private activity bonds set forth in § 146 of the Code. The qualified low-income building is placed in service after December 31, 2020. Any low-income housing credits earned with respect

[1] A governmental issuer may serve as a conduit between investors who buy bonds, such as exempt facility bonds, and a person (like Taxpayer X) that receives the bond proceeds and is solely responsible for debt service payments. That person is referred to as the "conduit borrower." See § 1.150-1(b) of the Income Tax Regulations.

to the building meet the requirements of § 42(h)(4)(A) for not counting against the State's housing credit ceiling.

Situation 2: Post-2020 issuance of a *de minimis amount of* exempt facility bonds. The facts are the same as in Situation 1, except that instead of borrowing pursuant to a draw-down loan that qualifies as an issue of exempt facility bonds, Agency issued an issue of exempt facility bonds in 2020 to finance the Conduit Borrower's construction of the new building for the qualified residential rental project. In a subsequent year, Agency issues a different issue of exempt facility bonds (not pursuant to a draw-down loan), in a *de minimis* amount, that the Conduit Borrower similarly uses to finance construction of the building.

Situation 3: Additional allocation of a *de minimis* housing credit dollar amount after 2020. Agency is a housing credit agency that allocates housing credit dollar amounts under § 42(h). In 2020, Agency and Taxpayer Y entered into a binding agreement. Under the agreement, Agency agreed to allocate to Y a housing credit dollar amount for the acquisition of an existing building and an additional housing credit dollar amount for the rehabilitation of the building into a qualified low-income building. In 2020, Agency made allocations both of the amount related to the acquisition and of the additional amount related to the rehabilitation. Each allocation qualified for an exception under § 42(h)(1)(E), and thus each was a valid carryover allocation. As a result of those qualifications for an exception under § 42(h)(1)(E), the State's housing credit ceiling for 2020 was reduced by the amounts of the two carryover allocations. Y completes the acquisition and rehabilitation of the building into a qualified low-income building and

places the building in service after December 31, 2020. After 2020, but before the building is placed in service, Agency makes an additional allocation of housing credit dollar amount related to the acquisition of the existing building. The amount of this additional allocation is *de minimis* and reduces Agency's ceiling for housing credit dollar amounts for the year after 2020 in which the allocation is made.

LAW

Section 42(a) provides that the amount of the low-income housing credit for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

Section 42(b)(1) provides rules to determine the applicable percentage. Section 42(b)(1)(A) defines the term "applicable percentage" with respect to any building as the appropriate percentage prescribed by the Secretary of the Treasury or her delegate (Secretary) for the earlier of (i) the month in which the building is placed in service, or (ii) at the election of the taxpayer—(I) the month in which the taxpayer and the housing credit agency enter into an agreement with respect to the building (which is binding on the agency, the taxpayer, and all successors in interest) as to the housing credit dollar amount to be allocated to such building, or (II) in the case of any building to which § 42(h)(4)(B) applies, the month in which the tax-exempt obligations are issued. A month may be elected under § 42(b)(1)(A)(ii) only if the election is made not later than the fifth day after the close of such month. Such an election, once made, is irrevocable.

Section 42(b)(2), which was enacted by section 3002(a)(1) of the Housing Assistance Tax Act of 2008 (2008 Act), Division C of the Housing and Economic

Recovery Act of 2008, Public Law 110-289, 122 Stat. 2654, 2879 (July 30, 2008), provides a minimum credit rate of 9 percent for new buildings that are not federally subsidized (9 percent floor). Section 3002(c) of the 2008 Act provides that the 9 percent floor under § 42(b)(2) applies to buildings placed in service after July 30, 2008.

Notice 2008-106, 2008-49 IRB 1239, provides guidance on application of the 9 percent floor. The notice clarifies that the 9 percent floor applies even if, before the 2008 Act, a taxpayer had made an irrevocable election under § 42(b)(1)(A)(ii) to apply to a building an applicable percentage that is less than 9 percent. The notice also concludes that: “Notwithstanding the application of the 9 percent floor, the housing credit dollar amount allocated to a project shall not exceed the amount the housing credit 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. See 42(m)(2).”

Section 201(a) of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Act), enacted as Division EE of the Consolidated Appropriations Act, 2021, Public Law 116-260, 134 Stat. 1182, 3056 (December 27, 2020), added to the Code a new § 42(b)(3), which provides a 4 percent minimum credit rate for buildings to which the 9 percent floor in § 42(b)(2) does not apply and which are placed in service by the taxpayer after December 31, 2020. The amendments to § 42(b) made by section 201(a) of the Act “apply to (1) any building which receives an allocation of housing credit dollar amount after December 31, 2020, and (2) in the case of any building any portion of which is

financed with an obligation described in section 42(h)(4)(A), any such building if any such obligation which so finances such building is issued after December 31, 2020." Section 201(b)(1) and (2) of the Act.

Section 42(d)(2)(B) provides that, except as provided in § 42(f)(5), a credit is allowable under § 42(a) by reason of rehabilitation expenditures that are treated as a new building under § 42(e) with respect to the building. Section 42(e)(1) provides that if rehabilitation expenditures are paid or incurred by the taxpayer with respect to any building and if the expenditures meet the criteria in § 42(e)(2) and (3), those expenditures are treated as a separate new building.

Under § 42(h)(1), the amount of the credit determined under § 42(a) for any taxable year with respect to any building must not exceed the housing credit dollar amount allocated to the building. Section 42(h)(1)(E) provides general rules for carryover allocations of the low-income housing credit. A carryover allocation is defined in § 1.42-6(a)(1) as an allocation that meets the requirements of § 42(h)(1)(E) (relating to carryover allocations for single buildings) or § 42(h)(1)(F) (relating to carryover allocations for multiple-building projects).

Section 42(h)(4)(A) provides an exception to the requirement in § 42(h)(1). Thus, a building within the exception can earn low-income housing credits without having received any allocation. The exception applies to the portion of any credit allowed under § 42(a) that is attributable to a building's eligible basis financed by an obligation the interest on which is exempt from tax under § 103 of the Code if: (i) the obligation is taken into account under § 146; and (ii) principal payments on the financing are applied

within a reasonable period to redeem obligations the proceeds of which were used to provide such financing or such financing is refunded under § 146(i)(6).

Section 42(m)(2)(D) provides that § 42(h)(4) does not apply to any project unless the governmental unit which issued the bonds makes a determination under rules similar to the rules provided for in § 42(m)(2)(A) and (B). Section 42(m)(2)(A) provides that a housing credit dollar amount allocated to a project cannot exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing credit project throughout the credit period. Under § 42(m)(2)(B) and § 1.42-17(a)(3), when a housing credit agency makes a determination under § 42(m)(2)(A), it must consider a number of factors including: (i) the sources and uses of funds and total financing planned for the project; (ii) any proceeds or receipts expected to be generated by reason of tax benefits; (iii) the percentage of housing credit dollar amount used for project costs other than the cost of intermediaries; and (iv) the reasonableness of the developmental and operational costs of the project.

Section 1.42-17(a)(4)(i) describes the timing of the housing credit agency determinations and certifications under § 1.42-17(a)(3). They must be made at (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. Section 1.42-17(a)(5) provides that, for the determination at the time the building is placed in service, the taxpayer must submit a schedule of project costs. Section 1.42-17(a)(6), provides that a project qualifying under § 42(h)(4) (concerning bond-financed

projects) is not entitled to any credit unless the governmental unit that issued the bonds, or the housing credit agency responsible for issuing the Form(s) 8609, *Low-Income Housing Credit Allocation and Certification*, to the project, makes determinations under rules similar to the rules in § 1.42-17(a)(3), (4), and (5).

Section 142 provides rules for exempt facility bonds. Section 142(a) provides that an exempt facility bond is any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to support certain categories of building projects, one of which is a qualified residential rental project. Section 142(d) generally defines a "qualified residential rental project" as any project for residential rental property if, at all times during the qualified project period and disregarding that part of the building in which such property is located that is used for purposes other than residential rental purposes, either (1) 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income, or (2) 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income.

Under § 1.150-1(c)(4)(i), bonds issued pursuant to a draw-down loan are treated as part of a single issue. The issue date of the issue is the first date on which the aggregate draws under the loan exceed the lesser of $50,000 or 5 percent of the issue price.

ANALYSIS

In a determination of whether the 4 percent floor applies, all the buildings described in the FACTS of this revenue ruling satisfy the requirement of § 42(b)(3) that a building

be placed in service after 2020. Each of these three situations, however, raises the question whether the post-2020 events in that situation meet the relevant portions of the effective date provisions in section 201(b) of the Act, which require a post-2020 issuance of a tax-exempt obligation or a post-2020 allocation of housing credit dollar amount.

An evaluation of the effect of these post-2020 events must consider the apparent reasons for the requirement in section 201(b) of the Act of certain post-2020 actions by State or local governments. For example, when section 3002 of the 2008 Act added the 9 percent floor, the effective date required only that a building be placed in service after July 30, 2008, the applicable date of enactment. Section 42(b)(3) also expressly provides such a placed-in-service effective date for the 4 percent floor. However, section 201(b) of the Act adds an additional requirement—application of the 4 percent floor to a qualified low-income building is also dependent on the existence of some post-2020 government action with respect to the building. The apparent reason for the additional effective date criteria in section 201(b) of the Act can be inferred by comparing buildings that satisfy only the placed-in-service requirement with those satisfying both that requirement and section 201(b) of the Act.

Considered in this way, section 201(b) of the Act functions to prevent a windfall of credits in situations where, prior to enactment of the 4 percent floor, the taxpayer had substantially completed the structuring of the transaction. Governmental determinations of financial feasibility under § 42(m)(2)(A) must occur not later than an allocation of housing credit dollar amounts or an issuance of exempt facility bonds for a qualified

residential rental project. Because the date of enactment of the Act occurred so late in 2020, absence of a post-2020 allocation or issuance means that the low-income building had been planned, and its financial feasibility had been assessed, without taking the 4 percent floor into account. Absent the restriction in section 201(b) of the Act, buildings would receive unnecessary and unanticipated credits on arrangements that had been structured and vetted to function without them. Thus, the requirements in section 201(b) of the Act seem to treat the possibility of those unplanned for credits as if they are a windfall to be avoided.

In Situation 1, the building is financed by a draw-down loan. Section 1.150-1(c)(4)(i) treats bonds issued pursuant to a draw-down loan as part of a single issue. Further, under § 1.150-1(c)(4)(i), the issue date of the issue in Situation 1 was in 2020 because amounts drawn exceeded the lesser of $50,000 or 5 percent of the issue price. This issue date of the issue in Situation 1 does not change under § 1.150-1(c)(4)(i) because a subsequent draw (that is, a bond) occurs after 2020.

The language of section 201(b)(2) of the Act refers to the issue date of the "obligation which so finances such building." Thus, the question here is whether this language refers to the issue or to the individual draws. Interpreting the "obligation" as the issue rather than the draws is consistent with the apparent intent of the effective date provisions in the Act, as discussed above. Although individual draws occur at various times, the maximum amount of the financing provided by the Loan was finalized before 2021. For example, in Situation 1, if the financing structure had been finalized during September 2020, the applicable percentage for that month was 3.07 percent.

See Table 4 of Rev. Rul. 2020-16, 2020-37 I.R.B. 550, 551. Hence, this is a situation where the transaction was structured assuming an applicable percentage that is not increased by a 4 percent floor. Accordingly, if the post-2020 draws under the 2020 issue caused the 4 percent floor to apply, the result would be a windfall of credits that were not taken into account when the transaction was structured.

Thus, in Situation 1, because the Loan (that is, the draw-down issue of bonds) was issued in 2020, the applicable percentage of the building is determined without regard to the 4 percent floor. The applicable percentage of the building is the amount determined under § 42(b)(1)(B) and (C) for the month determined under § 42(b)(1)(A).

Unlike the circumstances with the Loan in Situation 1 (which was a draw-down loan), the post-2020 bond proceeds in Situation 2 were from a post-2020 issuance of an exempt facility bond issue, and each post-2020 bond is part of that post-2020 issue. Thus, the Situation 2 analysis does not depend on whether the language of section 201(b)(2) of the Act refers to the issue date of a bond issue or to the issue date of the individual bonds.

In Situation 2, the Conduit Borrower receives financing from two issues of exempt facility bonds—one issued in 2020 and one issued in a later year. The latter issue, however, is only a *de minimis* amount. See Rev. Proc. 2021-43, page __ this bulletin, providing a safe harbor for determining whether an exempt facility bond issue that is issued after December 31, 2020, is more than *de minimis* for purposes of this revenue ruling. Because the building was placed in service after 2020, whether the 4 percent floor applies depends on the effect, if any, of the post-2020 *de minimis* issuance. That

is, the determination of whether the 4 percent floor applies depends on whether the post-2020 *de minimis* issuance satisfies the effective date requirement in section 201(b)(2) of the Act that a building be financed by a § 42(h)(4)(A) obligation issued after December 31, 2020.

As discussed in connection with Situation 1, section 201(b) of the Act functions to prevent windfalls. It is necessary, therefore, to consider whether a *de minimis* post-2020 financing could create a windfall of tax credits. When an issue of exempt facility bonds is issued in a non-*de-minimis* amount after 2020, any concern over a windfall of credits is lessened. In those situations, because the post-2020 issuance is not *de minimis*, the transaction is less likely to have been entirely structured prior to the enactment of the 4 percent floor. Further, a greater portion of the total credits generated by applying the 4 percent floor to the building would be expected to result from basis financed by the post-2020 issuance. Thus, it is consistent with the apparent intent of section 201(b) for the 4 percent floor to apply to buildings whose financing includes both pre-2021 exempt facility bonds and a non-*de-minimis* amount of exempt facility bonds that are part of an issue that is issued after December 31, 2020.

The situation is different, however, if a *de minimis* amount of bonds constitute a building's only exempt facility bonds issued as part of an issue issued after 2020. In this case, Situation 2 aligns more closely with a building whose only tax-exempt financing was issued before 2021 (even if it is placed in service after 2020). If a *de minimis* amount of post-2020 tax-exempt bond financing caused the project to qualify for the

4 percent floor, then that project would receive substantially more credit than an economically equivalent project all of whose tax-exempt financing was issued pre-2021.

Further, application of the 4 percent floor would produce an increase in credits not commensurate with the *de minimis* post-2020 financing. Except for the *de minimis* subsequent financing, the increased credit available by virtue of the 4 percent floor would be based on assets whose ability to yield low-income housing credits was the result of their pre-2021 financing. There is no indication that Congress contemplated such an incongruous result in drafting the effective date provisions in section 201(b) of the Act.

Moreover, the application of the 4 percent floor would create an undesirable incentive for taxpayers if a *de minimis* amount of post-2020 financing were held to satisfy section 201(b)(2) of the Act. Under this approach, taxpayers might seek nominal additional financing even in situations where the additional financing is not necessary for the financial feasibility of the building. Any such taxpayer efforts would increase complexity when housing credit agencies and bond issuers evaluate the financial feasibility of projects for purposes of § 42(m)(2)(D).

In addition, such a holding would undercut § 42(m)(2) and § 1.42-17, which guide housing credit agencies and bond issuers when they determine whether an amount is needed for the financial feasibility of a project. Those requirements reduce any incentive to seek *de minimis* amounts that are not necessary for the project's financial feasibility. There is no indication that Congress meant to interpret the effective date requirement to incentivize taxpayers to seek unnecessary amounts. This result is

avoided by interpreting section 201(b)(2) of the Act as describing only non-*de-minimis* post-2020 financing.

Thus, in Situation 2, the *de minimis* amount of exempt facility bonds that are part of an issue issued after 2020 fail to cause the 4 percent floor to apply to the building. See Rev. Proc. 2021-43, page __ this bulletin, providing a safe harbor for determining whether an exempt facility bond issue that is issued after December 31, 2020, is more than *de minimis* for purposes of this revenue ruling. Because the 4 percent floor does not apply, the applicable percentage is the amount determined under § 42(b)(1)(B) and (C) for the month determined under § 42(b)(1)(A).

This analysis would be the same for a building that is financed in part with proceeds of an exempt facility bond issue that was issued in 2020 and in part with a portion of the proceeds of a different exempt facility bond issue that is issued in a non-*de-minimis* amount after December 31, 2020 (primarily to finance one or more other buildings) when the portion of the proceeds of the exempt facility bond issue issued after December 31, 2020, that finances the building represents a *de minimis* portion of the building's overall exempt facility bond financing.

Finally, when the 4 percent floor applies to a building, it applies to any 30-percent-present-value applicable percentage used to compute low-income housing credits for the building. In these cases, therefore, it is irrelevant whether an election had been made under § 42(b)(1)(A)(ii) to use a pre-placed-in-service month for determining the applicable percentage. Cf. Notice 2008-106 (reaching a similar result when the 9 percent floor was enacted).

In Situation 3, Agency makes no more than a *de minimis* allocation of housing credit dollar amount after 2020. Although the acquisition of the building was completed after 2020, and the building was placed in service after 2020, the transaction was structured in 2020, and at that time, X and Agency did not take the 4 percent floor into account. Arguably, the windfall effect with an allocation is less than in a building financed with exempt facility bonds. The credits in this context are limited to those allocated by a housing credit agency. By contrast, in projects financed by § 42(h)(4)(A) obligations, the credits are limited only by what the qualified basis can generate. Nevertheless, the requirements of section 201(b)(1) of the Act manifest the same legislative intent as section 201(b)(2) of the Act and should therefore be interpreted consistently. Thus, the principles that govern *de minimis* amounts of bonds are equally applicable to *de minimis* allocations. See Rev. Proc. 2021-43, page __ this bulletin, providing a safe harbor for determining whether an allocation of a housing credit dollar amounts that is made after December 31, 2020, is more than *de minimis* for purposes of this revenue ruling. Accordingly, the 4 percent floor does not apply to the building described in Situation 3. X must use the applicable percentage determined under § 42(b)(1)(B) and (C) for the month determined under § 42(b)(1)(A).

As described above, when the 4 percent floor applies to a building, it applies to any 30-percent-present-value applicable percentage used to compute low-income housing credits for the building. In these cases, therefore, it is irrelevant whether an election had been made under § 42(b)(1)(A)(ii) to use a pre-placed-in-service month for determining the applicable percentage.

HOLDINGS

(1) Situation 1. The 4 percent floor under § 42(b)(3) does not apply to the building in Situation 1, which is financed in part with a draw-down exempt facility bond issue that was issued in 2020 and on which one or more draws are taken after December 31, 2020.

(2) Situation 2. The 4 percent floor under § 42(b)(3) does not apply to the building in Situation 2, which is financed in part with proceeds of an exempt facility bond issue that was issued in 2020 and in part with proceeds of a different exempt facility bond issue that is issued in a *de minimis* amount after December 31, 2020.

(3) Situation 3. The 4 percent floor under § 42(b)(3) does not apply to the building in Situation 3, which receives an allocation of housing credit dollar amount in 2020 and a de minimis additional allocation after December 31, 2020.

The analysis in this revenue ruling applies only for purposes of determining whether the 4 percent floor under § 42(b)(3) applies to a building.

DRAFTING INFORMATION

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