

INTERNAL REVENUE SERVICE
Revenue Procedure

LOW-INCOME HOUSING GUIDELINES

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26 CFR 601.201: Rulings and determination letters.

Low-income housing guidelines. Guidance on qualification for tax-exemption under section 501(c)(3) is provided for organizations that provide low-income housing. The guidance includes a safe-harbor procedure to determine qualification.

SECTION 1. PURPOSE

.01 This revenue procedure sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable as described in § 501(c)(3) of the Internal Revenue Code because they relieve the poor and distressed as described in § 1.501(c)(3)-1(d)(2) of the Income Tax Regulations. This revenue procedure also describes the facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed such that they will be considered charitable organizations described in § 501(c)(3). It also clarifies that housing organizations may rely on other charitable purposes to qualify for recognition of exemption from federal income tax as organizations described in § 501(c)(3). These other charitable purposes are described in § 1.501(c)(3)-1(d)(2). This revenue procedure supersedes the application referral described in Notice 93-1, 1993-1 C.B. 290.

.02 This revenue procedure does not alter the standards that have long been applied to determine whether low-income housing organizations qualify for tax-exempt status under § 501(c)(3). Rather, it is intended to expedite the consideration of applications for tax-exempt status filed by such organizations by providing a safe harbor and by accumulating relevant information on the existing standards for exemption in a single document. Low-income housing organizations that have ruling or determination letters and have not materially changed their organizations or operations from how they were described in their applications can continue to rely on those letters.

SEC. 2. BACKGROUND OF SAFE HARBOR

.01 Rev. Rul. 67-138, 1967-1 C.B. 129, Rev. Rul. 70-585, 1970-2 C.B. 115, and Rev. Rul. 76-408, 1976-2 C.B. 145, hold that the provision of housing for low-income persons accomplishes charitable purposes by relieving the poor and distressed. The Service has long held that poor and distressed beneficiaries must be needy in the sense that they cannot afford the necessities of life. Rev. Ruls. 67-138, 70-585, and 76-408 refer to the needs of housing recipients and to their inability to secure adequate housing under all the facts and circumstances to determine whether they are poor and distressed.

.02 The existence of a national housing policy to maintain a commitment to provide decent, safe, and sanitary housing for every American family is reflected in several federal housing acts. See, for example, § 2 of the United States Housing Act of 1937, 42 U.S.C. § 1437; § 2 of the Housing Act of 1949, 42 U.S.C. § 1441; § 2 of the Housing and Urban Development Act of 1968, 12 U.S.C. § 1701t; and §§ 101, 102, and 202 of the Cranston-Gonzalez National Affordable Housing Act, 42 U.S.C. §§ 12701, 12702, and 12721. Not all beneficiaries of these housing acts, however, are necessarily poor and distressed within the meaning of § 1.501(c)(3)-1(d)(2).

.03 In order to support national housing policy, the safe harbor contained in this revenue procedure identifies those low-income housing organizations that will, with certainty, be considered to relieve the poor and distressed. The safe harbor permits a limited number of units occupied by residents with

incomes above the low-income limits in order to assist in the social and economic integration of the poorer residents and, thereby, further the organization's charitable purposes. To avoid giving undue assistance to those who can otherwise afford safe, decent, and sanitary housing, the safe harbor requires occupancy by significant levels of both very low-income and low-income families.

.04 Low-income housing organizations that fall outside the safe harbor may still be considered organizations that offer relief to the poor and distressed based on all the surrounding facts and circumstances. Some of the facts and circumstances that will be taken into consideration in determining whether a low-income housing organization will be so considered are set forth in section 4.

.05 Low-income housing organizations may also qualify for tax-exempt status because they serve a charitable purpose described in § 501(c)(3) other than relief of the poor and distressed. Exempt purposes other than relief of the poor and distressed are discussed in section 6.

.06 To be recognized as exempt from income tax under § 501(c)(3), a low-income housing organization must not only serve a charitable purpose but also meet the other requirements of that section, including the prohibitions against inurement and private benefit. Specific concerns with respect to these prohibitions are set forth in section 7.

SEC. 3. SAFE HARBOR FOR RELIEVING THE POOR AND DISTRESSED

.01 An organization will be considered charitable as described in § 501(c)(3) if it satisfies the following requirements:

(1) The organization establishes for each project that (a) at least 75 percent of the units are occupied by residents that qualify as low-income; and (b) either at least 20 percent of the units are occupied by residents that also meet the very low-income limit for the area or 40 percent of the units are occupied by residents that also do not exceed 120 percent of the area's very low-income limit. Up to 25 percent of the units may be provided at market rates to persons who have incomes in excess of the low-income limit.

(2) The project is actually occupied by poor and distressed residents. For projects requiring construction or rehabilitation, a reasonable transition period is allowed for an organization to place the project in service. Whether an organization's transition period is reasonable is determined by reference to all relevant facts and circumstances. For projects that do not require substantial construction or substantial rehabilitation, a one-year transition period to satisfy the actual occupancy requirement will generally be considered to be reasonable. If a project operates under a government program that allows a longer transition period, this longer period will be used to determine reasonableness.

(3) The housing is affordable to the charitable beneficiaries. In the case of rental housing, this requirement will ordinarily be satisfied by the adoption of a rental policy that complies with government-imposed rental restrictions or otherwise provides for the limitation of the tenant's portion of the rent charged to ensure that the housing is affordable to low-income and very low-income residents. In the case of homeownership programs, this requirement will ordinarily be satisfied by the adoption of a mortgage policy that complies with government-imposed mortgage limitations or otherwise makes the initial and continuing costs of purchasing a home affordable to low and very low-income residents.

(4) If a project consists of multiple buildings and each building does not separately meet the requirements of sections 3.01(1), (2), and (3), then the buildings must share the same grounds. This requirement does not apply to organizations that provide individual homes or individual apartment units located at scattered sites in the community exclusively to families with incomes at or below 80 percent of the area's median income.

.02 In applying this safe harbor, the Service will follow the provisions listed below:

(1) Low-income families and very low-income families will be identified in accordance with the income limits computed and published by the Department of Housing and Urban Development ("HUD") in Income Limits for Low and Very Low-Income Families Under the Housing Act of 1937. The term "very low-

income" is defined by the relevant housing statute as 50 percent of an area's median income. The term "low-income" is defined by the same statute as 80 percent of an area's median income. However, these income limits may be adjusted by HUD to reflect economic differences, such as high housing costs, in each area. The income limits are then tailored to reflect different family sizes. If HUD's program terminates, the Service will use income limits computed under such program as is in effect immediately before such termination. Copies of all or part of HUD's publication may be obtained by calling HUD at (800) 245-2691 (HUD charges a small fee to cover costs of reproduction).

(2) The retention of the right to evict tenants for failure to pay rent or other misconduct, or the right to foreclose on homeowners for defaulting on loans will not, in and of itself, cause the organization to fail to meet the safe harbor.

(3) An organization originally meeting the safe harbor will continue to satisfy the requirements of the safe harbor if a resident's income increases and causes the organization to fail the safe harbor, provided that the resident's income does not exceed 140 percent of the applicable income limit under the safe harbor. If the resident's income exceeds 140 percent of the qualifying income limit, the organization will not fail to meet the safe harbor if it rents the next comparable non-qualifying unit to someone under the income limits.

(4) To be considered charitable, an organization that provides assistance to the aged or physically handicapped who are not poor must satisfy the requirements set forth in Rev. Rul. 72124, 1972-1 C.B. 145, Rev. Rul. 79-18, 1979-1 C.B. 194, and Rev. Rul. 79-19, 1979-1 C.B. 195. If an organization meets the safe harbor, then it does not need to meet the requirements of these rulings even if all of its residents are elderly or handicapped residents. However, an organization may not use a combination of elderly or handicapped persons and low-income persons to establish the 75-percent occupancy requirement of the safe harbor. An organization with a mix of elderly or handicapped residents and low-income residents may still qualify for tax-exempt status under the facts and circumstances test set forth in section 4.

SEC. 4. FACTS AND CIRCUMSTANCES TEST FOR RELIEVING THE POOR AND DISTRESSED

.01 If the safe harbor contained in section 3 is not satisfied, an organization may demonstrate that it relieves the poor and distressed by reference to all the surrounding facts and circumstances.

.02 Facts and circumstances that demonstrate relief of the poor may include, but are not limited to, the following:

(1) A substantially greater percentage of residents than required by the safe harbor with incomes up to 120 percent of the area's very low-income limit.

(2) Limited degree of deviation from the safe harbor percentages.

(3) Limitation of a resident's portion of rent or mortgage payment to ensure that the housing is affordable to low-income and very low-income residents.

(4) Participation in a government housing program designed to provide affordable housing.

(5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization's operations.

(6) The provision of additional social services affordable to the poor residents.

(7) Relationship with an existing 501(c)(3) organization active in low-income housing for at least five years if the existing organization demonstrates control.

(8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.

(9) Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.

(10) Existence of affordability covenants or restrictions running with the property.

SEC. 5. EXAMPLES

.01 Application of the safe harbor and the facts and circumstances test is illustrated by the following examples:

(1) Organization N operates pursuant to a government program to provide low and moderate income housing projects. Seventy percent of N's residents have incomes that do not exceed the area's low-income limit. Fifty percent of N's residents have incomes that are at or below the area's very low-income limit. Under the program, N restricts rents charged to residents below the income limits to no more than 30 percent of the applicable low or very low-income limits for N's area. N is close to meeting the safe harbor. N has a substantially greater percentage of very low-income residents than required by the safe harbor; it participates in a federal housing program; and it restricts its rents pursuant to an established government program. Although N does not meet the safe harbor, the facts and circumstances demonstrate that N relieves the poor and distressed.

(2) Organization O will finance a housing project using tax-exempt bonds pursuant to § 145(d). O will meet the 20-50 test under § 142(d)(1)(A). Another 45 percent of the residents will have incomes at or below 80 percent of the area's median income. The final 35 percent of the residents will have incomes above 80 percent of the area's median income. O will restrict rents charged to residents below the income limits to no more than 30 percent of the residents' incomes. O will provide social services to project residents and to other low-income residents in the neighborhood. Also, O will purchase its project through a government program designed to retain low-income housing stock. O does not meet the safe harbor. However, the facts and circumstances demonstrate that O relieves the poor and distressed.

(3) Organization R provides affordable homeownership opportunities to purchasers determined to be low-income under a federal housing program. The homes are scattered throughout a section of R's community. Beneficiaries under the program cannot afford to purchase housing without assistance. R's program makes the initial and continuing costs of mortgages affordable to the home buyers by providing assistance with down payments and closing costs. Homeowners assisted by R will have the following composition: 40 percent will not exceed 140 percent of the very low-income limit for the area, 25 percent will not exceed the low-income limit, and 35 percent will exceed the low-income limit but will not exceed 115 percent of the area's median income. R does not satisfy the safe harbor. However, the facts and circumstances demonstrate that R relieves the poor and distressed.

(4) Organization U will purchase existing residential rental housing financed using tax-exempt bonds issued in accordance with § 145(d). U will meet the minimum requirements of the 40-60 test of § 142(d)(1)(B). It will provide the balance of its units to residents with incomes at or above area median income levels. U has a community-based board of directors. U does not satisfy the safe harbor. Moreover, the facts and circumstances do not demonstrate that U relieves the poor and distressed.

(5) Organization V provides rental housing in a section of the city where income levels are well below the other parts of the city. All of V's residents are below the very low-income limits for the area, yet they pay rents that are above 50 percent of the area's very low-income limits. V has not otherwise demonstrated that the housing is affordable to its residents. Although the residents are all considered poor and distressed under the safe harbor, V does not relieve the poverty of the residents.

(6) Organization W provides homeownership opportunities to purchasers with incomes up to 115 percent of the area's median income. W does not meet the income levels required under the safe harbor. W's board of directors is representative of community interests, and W provides classes and counseling services for its residents. The facts and circumstances do not demonstrate that W relieves the poor and distressed.

SEC. 6. EXEMPT PURPOSES OTHER THAN RELIEVING THE POOR AND DISTRESSED

.01 Relief of the poor and distressed, whether demonstrated by satisfaction of the safe harbor described in section 3 of this Revenue Procedure or by reference to the facts and circumstances test described in section 4, does not constitute the only exempt purpose that a housing organization may have. Such organizations may qualify for exemption without having to satisfy the standards for relief of the poor and distressed by providing housing in a way that accomplishes any of the purposes set forth in § 501(c)(3) or § 1.501(c)(3)-1(d)(2). Those purposes include, but are not limited to, the following:

(1) Combatting community deterioration is an exempt purpose, as illustrated by Rev. Rul. 68-17, 1968-1 C.B. 247, Rev. Rul. 68-655, 1968-2 C.B. 213, Rev. Rul. 70-585, 1970-2 C.B. 115 (Situation 3), and Rev. Rul. 76-147, 1976-1 C.B. 151. An organization that combats community deterioration must (1) operate in an area with actual or potential deterioration, and (2) directly prevent or relieve that deterioration. Constructing or rehabilitating housing has the potential to combat community deterioration.

(2) Lessening the burdens of government is an exempt purpose, as illustrated by Rev. Ruls. 85-1 and 85-2, 1985-1 C.B. 178. An organization lessens the burdens of government if (a) there is an objective manifestation by the governmental unit that it considers the activities of the organization to be the government's burdens, and (b) the organization actually lessens the government's burdens.

(3) Elimination of discrimination and prejudice is an exempt purpose, as illustrated by Rev. Rul. 68-655, 1968-2 C.B. 213, and Rev. Rul. 70-585, 1970-2 C.B. 115 (Situation 2). These rulings describe organizations that further charitable purposes by assisting persons in specific racial groups to acquire housing for the purpose of stabilizing neighborhoods or reducing racial imbalances.

(4) Lessening neighborhood tensions is an exempt purpose, as illustrated by Rev. Rul. 68-655, 1968-2 C.B. 213, and Rev. Rul. 70-585, 1970-2 C.B. 115 (Situation 2). It is generally identified as an additional charitable purpose by organizations that fight poverty and community deterioration associated with overcrowding in lower income areas in which ethnic or racial tensions are high.

(5) Relief of the distress of the elderly or physically handicapped is an exempt purpose, as illustrated by Rev. Rul. 72-124, 1972-1 C.B. 145, Rev. Rul. 79-18, 1979-1 C.B. 194, and Rev. Rul. 79-19, 1979-1 C.B. 195. An organization may further a charitable purpose by meeting the special needs of the elderly or physically handicapped.

SEC. 7. OTHER CONSIDERATIONS

If an organization furthers a charitable purpose such as relieving the poor and distressed, it nevertheless may fail to qualify for exemption because private interests of individuals with a financial stake in the project are furthered. For example, the role of a private developer or management company in the organization's activities must be carefully scrutinized to ensure the absence of inurement or impermissible private benefit resulting from real property sales, development fees, or management contracts.

SEC. 8. EFFECT ON OTHER DOCUMENTS

Notice 93-1 is superseded.

SEC. 9. EFFECTIVE DATE

This revenue procedure is effective on [date of publication].

DRAFTING INFORMATION

The principal authors of this revenue procedure are Lynn Kawecky and Marvin Friedlander. For further information regarding this revenue procedure, contact Mr. Kawecky at (202) 622-7305 (not a toll free number).

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