

Chapter 18
Category 11m
Owner Did Not Properly
Calculate Utility Allowance

Definition

This category is used to report noncompliance with the utility allowance requirements outlined in Treas. Reg. §1.42-10. An allowance for the cost of any utilities, other than telephone, cable *television, or Internet,* paid directly by the tenant(s) *and not by or through the owner of the building* is included in the computation of gross rent under IRC §42(g)(2)(B). A separate estimate is computed for each utility and different methods can be used to compute the individual utility allowances. The utility allowance is computed on a building-by-building basis. The maximum rent that may be paid by the tenant must be reduced by utility allowance(s) obtained in the following manner.

1. If a building receives assistance from *the Rural Housing Service (RHS-assisted building)* then the utility allowance is *determined using the method prescribed by the Rural Housing Service (RHS) for the building, regardless of whether the building or its tenants also receive other state or federal assistance.
2. If any tenant in a building receives RHS rental assistance payments (RHS tenant assistance), the applicable utility allowance for all rent-restricted units is the applicable RHS utility allowance, including any units occupied by tenants receiving rental assistance payments from the Department of Housing and Urban Development (HUD).
3. If neither a building nor any tenant in the building receives RHS housing assistance, and the building's rents and utility allowances are reviewed by HUD on an annual basis (HUD-regulated building), then the applicable HUD utility allowance is the utility allowance for all rent-restricted units in the building.*
4. If a building is neither *an RHS-assisted* nor HUD-regulated, and no tenant receives *RHS tenant assistance, the applicable utility allowance for any rent-restricted unit occupied by tenants receiving HUD rental assistance payments (HUD tenant assistance) is the applicable Public Housing Authority (PHA) utility allowance established for the Section 8 Existing Housing Program.
5. Taxable years beginning before July 29, 2008: If neither the building nor tenants are subject to the rules described in 1-4 above, then the local public housing authority (PHA) allowance is used. However, if an estimate is obtained for any unit from a utility company, that estimate is used as the utility allowance for all similar units in the building.

Taxable years beginning after July 28, 2008: If neither the building nor tenants are subject to the rules described in 1-4 above, then the local public housing authority (PHA) allowance is used. However, if an estimate is obtained for any unit in the building, that estimate is used as the utility allowance for all similar

units in the building. Estimates may be obtained from a local utility company or a state or local housing credit agency, or calculated using HUD's Utility Schedule Model or an energy consumption model.^{1*}

PHA Utility Allowance

*Requirements for utility allowances are found in 24 CFR 982.517, Utility Allowance Schedule. The PHA must provide a utility allowance for utilities and services that are necessary in the locality to provide housing that complies with the housing quality standards. The PHA must classify utilities and other housing services according to specific categories and the allowance for each category must be separately stated.

Taxable Years Beginning Before July 29, 2008

State agencies reported that the local PHA utility allowances did not always reflect a fair approximation of actual utility costs for such buildings. Accordingly, until further guidance was provided in Treas. Reg. 1.42-10,² taxpayers were allowed to calculate utility allowances for the rent-restricted units in the building based upon an average of the actual use of similarly constructed and sized units *in the building* using actual utility usage data and rates, provided that the taxpayer had written approval from the state agency.

If an owner computed the utility allowance estimates based on the expected or historical use by the LIHC buildings/units, the estimate must have been calculated in a reasonable manner and *contemporaneously* documented³ to show how the estimate was determined. State agencies were required to review the methodology used to calculate the estimate for reasonableness, and ensure that the estimate is computed accurately.*

Paid Directly by the Tenants and not by or through the Owner of the Building – For Taxable Years Beginning after July 28, 2008

*Some buildings in qualified low-income housing projects are sub-metered. Sub-metering measures tenants' actual utility consumption, and tenants pay for the utilities they use. A sub-metering system typically includes a master meter, which is owned or controlled by the utility supplying the electricity, gas, or water, with overall utility consumption billed to the building owner. In a sub-metered system, building owners (or their agents) use unit-based meters to measure utility consumption and prepare a bill for each residential unit based on consumption. The building owners (or their agents) retain records of resident utility consumption, and tenants receive documentation of utility costs as specified in the lease.

Notice 2009-44⁴ clarifies that, for purposes of Treas. Reg. §1.42-10(a), utility costs paid by a tenant based on actual consumption in a sub-metered rent-restricted unit are treated as paid directly by the tenant, and not by or through the owner of the building. For RHS-assisted buildings, buildings with RHS tenant assistance, HUD-regulated buildings, and rent-restricted units in other buildings occupied by tenants receiving HUD rental assistance, the applicable RHS or HUD rules apply. For all other tenants in rent-restricted units in other buildings:

¹ *The additional options for determining utility allowances apply to buildings subject to TD 9420, which was published on July 29, 2008, in the Federal Register. See reference #3 for additional information.*

² *See footnote 1 above.*

³ IRC §6001 requires all taxpayers to keep adequate records to support the items represented on their tax returns, including utility allowances.

⁴ *I.R.B. 2009-21 1037.*

1. The utility rates charged to tenants in each sub-metered rent-restricted unit must be limited to the utility company rates incurred by the building owners (or their agents);
2. If building owners (or their agents) charge tenants a reasonable fee for the administrative costs of sub-metering, then the fee will not be considered gross rent under IRC §42(g)(2). The fee must not exceed an aggregate amount per unit of 5 dollars per month unless State law provides otherwise; and
3. If the costs for sewerage are based on the tenants' actual water consumption determined with a sub-metering system and the sewerage costs are on a combined water and sewerage bill, then the tenants' sewerage costs are treated as paid directly by the tenants for purposes of the utility allowances regulations.

Notice 2009-44 is effective for utility allowances subject to the effective date in Treas. Reg. §1.42-12(a)(4). Consistent with Treas. Reg. §1.42-12(a)(4), building owners (or their agents) may rely on Notice 2009-44 for any utility allowances effective no earlier than the first day of the building owner's taxable year beginning on or after July 29, 2008.*

Utility Company Estimates

Under Treas. Reg. §1.42-10(b)(4)(ii)(B), any interested party (tenant, owner, or state agency) may request a written estimated cost of that utility for a unit of similar size and construction *for the geographic area in which the building is located*. This estimate becomes the appropriate utility allowance for all rent-restricted units of similar size and construction in the building. The local utility estimate is not available to buildings/tenants subject to Rural Housing Service or HUD jurisdiction.

*Taxable Years Beginning Before July 29, 2008

Before Treas. Reg. §1.42-10 was revised, the election to use a local utility company estimate was permanent; i.e., the taxpayer could not switch back and forth between the local PHA and utility company estimates. State agencies reported that although utility companies may have been willing to provide interested parties (owner, tenant, state agency) with an initial estimate, utility companies were increasingly unwilling to provide estimates on an on-going basis. Accordingly, until the regulation was revised, the IRS did not challenge the owner's return to using the applicable PHA utility allowance, provided that:

1. The taxpayer has demonstrated to the state agency that the local utility company was unwilling to provide an updated estimate, and
2. The owner had *written* approval from the state agency to use a mutually agreed upon utility allowance.

Taxable Years Beginning After July 28, 2008*

If neither the building nor tenants are subject to the rules described in 1-4 above, then the local public housing authority (PHA) allowance is used. However, if an estimate is obtained for any unit in the building, that estimate is used as the utility allowance for all similar units in the building. *Estimates may be obtained from a local utility

company or a state or local housing credit agency, or calculated using HUD's Utility Schedule Model or an energy consumption model.

In the case of deregulated utility services, the interested party is required to obtain an estimate from only one utility company even if multiple companies can provide the same utility service to the unit. However:

1. The utility company must offer utility services to the building in order for that utility company's rates to be used in calculating the utility allowance.
2. The estimate should include all component deregulated charges for providing the utility service.

The utility allowance is "obtained" when the building owner receives, *in writing*, information from the utility company providing the estimated per unit cost of the utility. Receipt of the information from the utility company begins the 90-day period after which the new utility allowance must be used to compute gross rents.*

***State or Local
Housing Credit
Agency -
Taxable Years
Beginning
After July 28,
2008***

Under Treas. Reg. §1.42-10(b)(4)(ii)(C)⁵, a building owner may obtain a utility allowance from the state agency that has jurisdiction over the building, provided the state agency agrees to provide the estimate. The building owner may obtain a utility allowance at any time during the building's extended use period⁶ and the associated costs are borne by the building owner.

The utility allowance is "obtained" when the building owner receives, *in writing*, information from the state agency providing the estimated per unit cost of the utility. Receipt of the information from the state agency begins the 90-day period after which the new utility allowance must be used to compute gross rents.

Factors to Consider

The utility allowance must take into account, among other things, (1) local utility rates, (2) property type, (3) climate and degree-day variables by region in the state, (4) taxes and fees on utility charges, (5) building materials, and (6) mechanical systems.

Actual Building Usage

The state agency may use actual utility company usage data and rates of the building for which the utility allowance is requested.

1. The data used to compute the estimate is limited to the building's consumption data for a 12-month period ending no earlier than 60 days prior to the date the utility allowance will change. For newly constructed or renovated buildings with less than 12 months of consumption data, consumption data for the 12-month period for similarly sized and constructed units in the geographical area in which the building is located will be used.

⁵ *As amended by TD 9420.*

⁶ *Under IRC §42(h)(6)(D), the extended use period begins on the first day of the building's 15-year compliance period under IRC §42(i)(1) and ends on the later of the date specified in the agreement or 15 years after the close of the compliance period.*

2. The utility rates used to compute the estimates must be the rates in place 60 days prior to the date the utility allowance will change.

Estimates Provided by State Agency's Agent or Private Contractor

A state agency may use an agent or other private contractor to calculate the utility estimates. The agent or contractor must be a properly licensed engineer or a qualified professional. A qualified professional must be (1) approved by the state/local housing credit agency having jurisdiction over the building, and (2) must not be related to the building owner within the meaning of IRC §§ 267(b)⁷ or 707(b)⁸.

HUD Utility Schedule Model - Taxable Years Beginning After July 28, 2009

*Under Treas. Reg. §1.42-10(b)(4)(ii)(D)⁹, a building owner may calculate a utility allowance using the "HUD Utility Schedule Model" that can be found on HUD's Internet site, the Low-Income Housing Tax Credits page at www.huduser.org/datasets/lihtc.html or successor URL.

Utility rates used for the HUD Utility Schedule Model must be no older than the rates in place 60 days prior to the date the utility allowance will change.

The utility allowance is deemed "obtained" based on the date entered as the "Form Date" on the "Location" spreadsheet of the Utility Schedule Model. This date will also be reflected on the Form 52667, Allowances for Tenant-Furnished Utilities and Other Services. This date begins the 90-day period after which the new utility allowance must be used to compute gross rents.*

Energy Consumption Model - Taxable Years Beginning After July 28, 2009

*Under Treas. Reg. §1.42-10(b)(4)(ii)(E)¹⁰, a building owner may calculate a utility allowance using an energy and water and sewage consumption analysis model (energy consumption model).

Factors to Consider

The energy consumption model must, at a minimum, take into account specific factors including, but not limited to: (1) unit size, (2) building orientation, design and materials, mechanical systems, appliances, and characteristics of the building location.

Building's Consumption Data and Utility Rates

The data used to compute the estimate is limited to the building's consumption data for a 12-month period ending no earlier than 60 days prior to the date the utility allowance will change. For newly constructed or renovated buildings with less than 12 months of consumption data, consumption data for the 12-month period for similarly sized and constructed units in the geographical area in which the building is located will be used.

The utility rates used for the energy consumption model must be the rates in place 60 days prior to the date the utility allowance will change.

⁷ *See note 1 at the end of the chapter.*

⁸ *See note 2 at the end of the chapter.*

⁹ *As amended by TD 9420.*

¹⁰ *As amended by TD 9420.*

Estimates Provided by Licensed Engineer or Qualified Professional

The utility allowance must be prepared by a properly licensed engineer or a qualified professional. A qualified professional must be (1) approved by the state/local housing credit agency having jurisdiction over the building, and (2) must not be related to the building owner within the meaning of IRC §§ 267(b) or 707(b)¹¹.*

Annual Review - Taxable Years Beginning After July 28, 2009

*Under Treas. Reg. §1.42-10(c)(2)¹², a building owner *must* review the basis on which utility allowances have been established at least once during each calendar year and must update the allowance if required. Building owners *may* choose to calculate new utility allowances more frequently than once during a calendar year, provided the owner complies with the requirement of Treas. Reg. 1.42-10, including the requirement to notify the state/local housing credit agency and tenants.

First Year of the Credit Period

No review is required until the building has achieved 90 percent occupancy for a period of 90 consecutive days, or by [at] the end of the first year of the credit period, whichever is earlier. If the review is completed at the end of the year, the consumption rates as of December 31st of the first year of the credit period. Consequently, the 90-day period will begin no later March 1 of the year subsequent to the first year of the credit period.

Review Requirements

1. The review must take into account any changes to the building such as any energy conservation measures and affect energy consumption and changes in utility rates.
2. Owners may use different methods for computing the allowances for different utilities.
3. Owners are not prohibited from changing methods used for calculating a utility allowance in order to most accurately estimate the utility allowance.*

Updating Utility Allowances – *Taxable Years Beginning Before July 29, 2008*

If the applicable utility allowance for a unit changes, the new utility allowance must be used to compute gross rents of LIHC units due 90 days after the change. As a practical matter, utility allowances are usually reviewed when HUD updates the Area Median Gross Income (AMGI) for the location (which may change the allowable gross rent). If the applicable utility allowance for a unit changes, the new allowance must be used to compute gross rents due 90 days after the change.

*PHA Utility Estimates

As explained in 24 CFR 982.517, Utility Allowance Schedule, paragraph (4)(c)(1), a PHA must review its schedule of utility allowances each year, and must revise its allowance for a utility category if there has been a change of 10 percent or more since the last time the utility allowance was revised. The 90-day implementation period begins when the PHA makes revised utility allowances available.*

¹¹ *See note 2 at the end of the chapter.*

¹² *As amended by TD 9420.*

***Updating
Utility
Allowances –
Taxable Years
Beginning
After July 28,
2008***

*If the applicable utility allowance for a unit changes, the new utility allowance must be used to compute gross rents of LIHC units due 90 days after the change (90-day period). However, an owner is not required to implement new utility allowances until the building has achieved 90 percent occupancy for a period of 90 days or by the end of the first year of the credit period, whichever is earlier.

PHA Utility Estimates

As explained in 24 CFR 982.517, Utility Allowance Schedule, paragraph (4)(c)(1), a PHA must review its schedule of utility allowances each year, and must revise its allowance for a utility category if there has been a change of 10 percent or more since the last time the utility allowance was revised. The 90-day implementation period begins when the PHA makes revised utility allowances available.

Utility Company and State/Local Housing Credit Agency Estimates

If an owner obtains a utility estimate from a local utility company or state/local housing credit agency, the 90-day period will begin with the receipt of the information. The date of receipt is determined based on the date of the correspondence.

Example 1: Lower Estimate Obtained from Utility Company

The rent for an LIHC building must be lowered because a local utility company estimate obtained by the owner shows a higher utility cost than the utility allowance currently being used. The utility company's letter is dated August 15, 2008. The lower rent must be in effect for rent due after November 13, 2008.

HUD's Utility Schedule Model

The date entered as the "Form Date" on the "Location" spreadsheet of the Utility Schedule Model and reflected on the Form 52667, Allowances for Tenant-Furnished Utilities and Other Services, begins the 90-day period after which the new utility allowance must be used to compute gross rents.

Energy Consumption Model

The 90-day period will begin 60 days after the end of the last month of the 12-month period for which data was used to compute the estimate.

Notification Requirements

1. If the owner obtained a utility allowance from a state or local housing credit agency, the owner must make the utility estimate available to all tenants in the building at the beginning of the 90-day period.
2. If the owner obtained a utility allowance from a utility company, using the HUD Utility Schedule Model, or calculated using an energy consumption model, the owner must (1) submit copies of the utility estimates to the agency having

jurisdiction over the building and (2) make the utility estimate available to all tenants in the building at the beginning of the 90-day period. An agency may require additional information from the owner during the 90-day period.*

***Cost of
Securing Utility
Estimates -
Taxable Years
Beginning
After July 28,
2009***

The building owner must pay all the costs incurred in obtaining the estimates from a utility company or state/local housing credit agency, HUD's Utility Schedule Model, or an energy consumption model. The building owner also bears the costs of notifications to the tenants and state/local agency.

***Record
Retention***

*The building owner must retain any consumption estimates and supporting data as part of the *taxpayer's* records for purposes of Treas. Reg. 1.6001-1(a). Under this requirement, taxpayers are required to keep such permanent books of account or records as are sufficient to establish the amount of gross income, deductions, *credits*, or *other matters required to be shown* by such person.

Under Treas. Reg. 1.6001-1, the IRS may require the owner to render such statements or keep such specific records as will enable the IRS to determine whether or not the owner is liable for tax. The books and records shall be kept at all times available for inspection by the IRS and shall be retained so long as the contents thereof may become material in the administration of the Internal Revenue Code.*

In Compliance

Low-income housing projects are in compliance when the appropriate utility allowance is used, the utility allowance is properly calculated, and rents are reduced for a utility allowance when utilities are paid directly by the tenant.

Owners must demonstrate that the basis on which utility allowances have been established (consumption and rates) have been reviewed at least once during each calendar year. If applicable, the owner must also demonstrate that (1) tenants and the state/local housing credit agency have been timely notified of any changes, and (2) the new utility allowance was used to compute gross rents for LIHC units due after the end of the 90-day period.^{13}

Example 1: Utility Allowance Increases

The maximum gross rent is \$500. The owner charged rent of \$450, which reflected a \$50 utility allowance; i.e., \$450 rent + \$50 utility allowance = \$500 gross rent. The annual utility allowance estimate increases to \$75. The owner reduces the rent to \$425 based upon the increased utility allowance of \$75; for a gross rent of \$500 (\$425 + \$75 = \$500).

¹³ *The 90-day period applies to taxable years beginning after July 28, 2008 utility allowances.*

Example 2: Local Utility Company No Longer Provides Estimates

The owner used estimates of utility use as provided by the local utility company to determine the utility allowance. The owner asked the local utility company for an updated estimate of use by similar units in the local area. The utility company informed the owner that they no longer provide estimates. *The owner may select another method for computing the utility allowance.¹⁴*

Example 3: *First Year of the Credit Period

An owner acquired an existing building and completed substantial rehabilitations. The building has 100 rental units and was placed in service on November 7, 2008. The owner elected to begin the credit period the year after the building was placed in service, on January 1, 2009. All 51 of the in-place tenants were determined to be income-qualified households at that time.

The owner chose to use the energy consumption model and correctly determined the utility allowance using consumption data for similarly sized and constructed units in the geographical area for the period November 1, 2007 through October 31, 2008 and the utility rate on October 31, 2008.

The owner rented the 91st unit in May of 2009 and maintained an occupancy rate of at least 94% through the end of August 2009. Since the owner had achieved 90% occupancy for 90 consecutive days, the owner was required to conduct a utility allowance review. If applicable, the utility allowances should be updated.*

Example 4: Increased Utility Allowance Does Not Cause Rent to Exceed Limit

The maximum gross rent limit is \$500, but the owner charged \$415 rent and a \$50 utility allowance for a total of \$465. The utility allowance increases to \$60 the next year. The owner makes no adjustment to the rent. The owner is in compliance. The owner is charging \$415 rent and a \$60 utility allowance for a total of \$475, which continues to be below the gross rent limit of \$500.

Out of Compliance

Low income housing projects are considered out of compliance when:

1. the appropriate utility allowance is not used,
2. the utility allowance is not properly calculated,
3. rents are not reduced for a utility allowance when utilities are paid directly by the tenant *to the utility provider,

¹⁴ *Most of the optional methods are only available for taxable years beginning after July 28, 2008 utility allowances.*

4. the owner did not review the basis on which the utility allowance is established at least once during the calendar year,¹⁵
5. The owner failed to update rents for a revised utility allowance after the 90-day period.¹⁶
6. The owner failed to maintain adequate documentation regarding the computation of utility allowances;* without proof of the amount of the allowance *and how it was estimated,* there is no way to correctly compute the rent.

Back in Compliance

A unit is considered back in compliance when the rent charged is reduced and correctly reflects the utility allowance. The date of correction is date that the rents correctly reflect the utility allowance.

Example 1: The maximum gross rent is \$500. Beginning on March 1, 2003, the owner charged \$450 rent and a \$75 utility allowance; the total rent is \$525. The rent is \$25 over the ceiling. The error was discovered during a state agency's review on April 13, 2004.

The owner immediately reduces the rent charged to \$425 for rents due beginning on May 1, 2004. The effective date of the new rent, or May 1, 2004, is the date the units are back in compliance.

References

1. Notice 89-6, 1989-1 C.B. 625.
2. Treas. Reg. 1.42-10.
3. *TD 9420. Treas. Reg. § 1.42-12(a) provides the following effective dates and transitional rules under TD 9420: The first sentence in §1.42-10(a), §1.42-10(b)(1), (2), (3), and (4), the last two sentences in §1.42-10(b)(4)(ii)(A), the third, fourth, and fifth sentences in §1.42-10(b)(4)(ii)(B), §1.42-10(b)(4)(ii)(C), (D), and (E), and §1.42-10(c) and (d) are applicable to a building owner's taxable years beginning on or after July 29, 2008. Taxpayers may rely on these provisions before the beginning of the building owner's taxable year beginning on or after July 29, 2008, provided that any utility allowances calculated under these provisions are effective no earlier than the first day of the building owner's taxable year beginning on or after July 29, 2008. The utility allowances provisions that apply to taxable years beginning before July 29, 2008 are contained in §1.42-10 (see 26 CFR part 1 revised as of April 1, 2008).*

Notes

1. *IRC §267(b), Relationships.
(1) Members of a family, as defined in subsection (c)(4)¹⁷;

¹⁵ *Applies to taxable years beginning after July 28, 2008 utility allowances.*

¹⁶ *Applies to taxable years beginning after July 28, 2008 utility allowances.*

¹⁷ *The family of an individual shall include only his brothers and sisters (whether by the whole or half blood) spouse, ancestors, and lineal descendants.*

- (2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;
- (3) Two corporations which are members of the same controlled group (as defined in subsection (f)¹⁸);
- (4) A grantor and a fiduciary of any trust;
- (5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
- (6) A fiduciary of a trust and a beneficiary of such trust;
- (7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
- (8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;
- (9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;
- (10) A corporation and a partnership if the same persons own—
 - (A) more than 50 percent in value of the outstanding stock of the corporation, and
 - (B) more than 50 percent of the capital interest, or the profits interest, in the partnership;
- (11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;
- (12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or
- (13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.*

2. *IRC §707(b)

- (1) --
 - (A) a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or
 - (B) two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.
- (2) –
- (3) Ownership of a capital or profits interest. For purposes of paragraphs (1) and (2) of this subsection, the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section.*

¹⁸ *IRC §267(f) refers to IRC §1563 to define controlled groups for (1) parent-subsidiary groups, except that “more than 50 percent” is substituted for “at least 80 percent,” (2) brother-sister groups, (3) combinations of parent-subsidiary and brother-sister groups, and (4) certain insurance companies.*