April 5, 2019

IRS Clarifies Occupancy Preference Rules

On April 3, 2019, the IRS released Revenue Procedure 2019-17, I.R.B. 2019-17 ("Rev. Proc. 2019-17"), which clarified certain matters relating to occupancy preferences in qualified residential rental projects under section 142(d) of the Internal Revenue Code ("the Code"). Rev. Proc. 2019-17 says that private activity bonds issued to finance residential rental projects under section 142(d) do not fail to meet the general public use requirement applicable to exempt facilities if they contain occupancy restrictions or preferences that favor the groups described in section 42(g)(9), including veterans. Kutak Rock's Section 103 Tax Group had previously noted that the difference in how occupancy preferences are treated between sections 42 and 142 could prevent tax-exempt bonds financing such projects from complying with the Code, rendering them taxable.

The upshot of Rev. Proc. 2019-17 is that the split between the bond rules under section 142 and the tax credit rules under section 42 regarding such preferences has been removed, and that projects with certain occupancy preferences can be financed with tax-exempt bonds. The applicable groups are (1) people with special needs, (2) people in groups favored under a federal or state program or policy that supports housing for such groups (such as veterans), and (3) people involved in literary or artistic activities.

In order to comply with the rules for tax-exempt bonds, qualified residential rental projects have to be available for use by the general public. The rules applicable to Low Income Housing Tax Credits ("LIHTC") contain a similar requirement, however a number of years ago section 42(g)(9) was added to the Code in order to allow projects that favored the groups listed above to benefit from LIHTC financing. No similar provision was added to section 142. Most LIHTC-financed deals contain a tax-exempt bond financing component, so the split in the requirements for the two was problematic for those attempting to structure multifamily housing deals. With the release of Rev. Proc. 2019-17, issuers and developers can use tax-exempt bond financing to provide housing focused on the communities noted above, even without a LIHTC component to the deal.

Delivering housing for military veterans has been an area of focus for many in the housing markets in recent years, and Rev. Proc. 2019-17 mentions them specifically. Worthy of note, however, is the inclusion of special needs communities protected under section 42(g)(9) within the scope of Rev. Proc. 2019-17. Populations that fit within this category include those with mental illnesses, developmental or other disabilities, HIV-positive people, victims of domestic abuse, and the homeless. Qualified residential rental projects benefitting these communities, as well as writers and artists, now have greater latitude in structuring. Recently proposed programs that would, for example, provide housing to teachers, workforce members, farmworkers, or first responders may also come within the parameters of Rev. Proc. 2019-17 and can be further evaluated.

Rev. Proc. 2019-17 was effective when released on April 3, 2019, and has a retroactive effect covering existing projects that already have these occupancy preferences.

Additional Information

Kutak Rock's Section 103 Tax Group is available to help with any questions about this revenue procedure, or other tax questions, at the points of contact below:

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