[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9850]

RIN 1545-BM28

Utility Allowance Submetering

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that amend the utility allowance regulations concerning the low-income housing credit under section 42 of the Internal Revenue Code (Code). These final regulations extend the principles of the current submetering rules. The current rules address situations in which a building owner purchases a utility from a utility company and then separately charges the tenants for the utility. In those situations, if the utility costs paid by a tenant are based on actual consumption in the tenant's submetered, rent-restricted unit and if certain other requirements are satisfied, then the charges for the utility are treated as paid by the tenant directly to the utility company, even though the payment passes through the building owner. The final regulations extend these principles and apply to situations in which a building owner sells to tenants energy that is produced from a renewable source and that the owner did not purchase from or through a local utility company. The final regulations affect owners of low-income housing projects that claim the credit, the tenants in those low-income housing projects, and the State and local housing credit agencies that administer the credit.

DATES: Effective date: These final regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability date: For dates of applicability, see §1.42-12(a)(5).

FOR FURTHER INFORMATION CONTACT: Dillon Taylor, (202) 317-4137 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On March 3, 2016, the Department of the Treasury (Treasury Department) and the IRS published in the **Federal Register** (81 FR 11104) final and temporary regulations (TD 9755) that amended §1.42-10 of the Income Tax Regulations. The final regulations in TD 9755 clarified the circumstances in which utility costs paid by a tenant based on actual consumption in a submetered, rent-restricted unit are treated as paid by the tenant directly to the utility company and not to the building owner. In such a case, for purposes of section 42, the tenant's payments to the owner for the utilities are not treated as payments of gross rent, and the rent that the owner might otherwise have collected for the unit is reduced by an amount that is called a "utility allowance." The temporary regulations extended the principles of those final regulations to situations in which a building owner sold to tenants energy that was produced from a renewable source and that the owner had not purchased from or through a local utility company.

In the same issue of the **Federal Register** (81 FR 11160), the Treasury Department and the IRS published a notice of proposed rulemaking (REG-123867-14) (the proposed regulations). The text of the proposed regulations incorporated by cross-reference the text of the temporary regulations. The Treasury Department and the IRS

received written and electronic comments responding to the proposed regulations. No requests for a public hearing were made, and no public hearing was held.

After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury Decision.

Summary of Comments and Explanation of Provisions

The temporary regulations in TD 9755 applied the submetering principles to energy that the building owner sold to tenants if the energy was "produced from a renewable source" and if the owner had acquired it from the renewable source without the intervention of a local utility company. Qualification for this submetering treatment, however, depended on the charges to the tenants for this energy being comparable to local utility rates. That is, under the temporary regulations, to the extent that tenants consumed this energy, the rate charged by the building owner could not exceed the rate at which the local utility company would have charged the tenants if they had instead acquired the energy from that company.

A commenter requested that the final regulations clarify how a building owner may demonstrate that the rate that the owner charges tenants for renewable energy satisfies this requirement (the evidentiary issue). In addition, if there are multiple local utility rates that the tenants might have been charged (possibly from multiple utility companies), the commenter asked for clarification as to which rate or rates should be taken into account in determining whether the owner's charges to the tenants qualify (the reference-rate issue).

The final regulations resolve both of these issues. Addressing the reference-rate issue, the final regulations require that the rate that the owner charges must not exceed

the highest rate at which the tenants might have obtained energy from a local utility company. This criterion has several advantages over alternatives. For example, it is easily administrable (as compared, for example, with a requirement that the owner's rate not exceed the "most typical rate" in the community). Also, the criterion protects an owner's qualifying rate from being disqualified by the introduction of new rates in the community (as might be the case, for example, if the reference for the criterion were the average or median of local rates).

Regarding the evidentiary issue, in determining the acceptability of the rate that a building owner charges tenants, the owner may rely on the rates published by local utility companies.

The temporary regulations in TD 9755 provide that, for purposes of qualifying for submetering treatment, energy is "produced from a renewable source" if it is energy that is produced from energy property described in section 48; energy that is produced from a facility described in section 45(d)(1), (2), (3), (4), (6), (9), or (11); or energy that is described in guidance published for this purpose in the Internal Revenue Bulletin. Sections 45 and 48 of the Code determine whether a taxpayer is entitled to certain energy-related credits. A commenter requested that the final regulations clarify the extent to which these cross-references to "energy property" and "facility" incorporate the various requirements for earning those credits.

The final regulations clarify that the building owner need not own the source from which the utility is produced and need not qualify for, or receive, any credit under section 45 or 48 associated with the source. Indeed, energy may qualify as "produced from a renewable resource" even if potential entitlement to credits under these Code

sections has expired. Thus, the final regulations clarify that they refer to "energy property" and "facility" as a means of describing certain types of production of renewable energy but that they do not also incorporate any other criteria from those Code sections.

Under section 42(g)(1) and (2), a residential unit may qualify as a low-income unit only if it is "rent-restricted." The amount that qualifies as restricted rent is determined based on the assumption that most utilities are generally covered by that rent. See H.R. Conf. Rep. 99–841, at II–94 (1986). For that reason, if the tenant pays for a utility directly, the rent that the owner may require from the tenant is reduced. The amount of this reduction is called a "utility allowance." See section 42(g)(2)(B)(ii) and §1.42-10(a). Language in the preamble of TD 9755 states that utility costs paid by a tenant based on actual consumption in a submetered, rent-restricted unit are treated as paid by the tenant directly to the utility and thus do not count against the maximum rent that the building owner can charge. Referencing this language, one commenter requested that the final regulations clarify whether a building owner of a submetered building is required to reduce its maximum gross rents by the amount of a utility allowance. Because §1.42-10(e) treats a tenant in a submetered, rent-restricted unit as having paid for a utility directly and not by or through the owner of the building, the proper treatment of the tenant's submetered utility payments is the same as if the tenant had made those payments directly to the utility company—(1) Although the payments pass through the building owner, they are not treated for purposes of the rent restriction as if they were payments of rent; and (2) The amount of rent that the owner might

otherwise have demanded from the tenant is reduced by the amount of an applicable utility allowance.

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 Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Therefore, a regulatory impact assessment is not required. It has also been determined that the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because the regulations do not impose a collection of information on small entities. Pursuant to section 7805(f) of the Internal Revenue Code, this proposed rule preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business and no comments were received.

Drafting Information

The principal author of this regulation is James W. Rider, formerly of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in its development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for § 1.42–10T to read in part as follows:

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

Sections 1.42–6, 1.42–8, 1.42–9, 1.42–10, 1.42–11, and 1.42–12, also issued under 26 U.S.C. 42(n).

§ 1.42-0T [Amended]

Par. 2. Section 1.42-0T is amended by removing the entries for §1.42-10T.

Par. 3. Section 1.42-10 is amended by:

1. Revising paragraph (e)(1)(i) introductory text.

2. Revising paragraph (e)(1)(i)(B).

3. Adding paragraphs (e)(1)(i)(C) and (D).

4. Revising paragraph (e)(1)(iv)(B).

The revisions and additions read as follows:

§1.42-10 Utility allowances.

* * * * *

(e) * * *

(1) * * *

(i) The utility consumed in the unit is described in paragraph (e)(1)(i)(A) or (e)(1)(i)(B) of this section;

* * * * *

(B) The utility is not purchased from or through a local utility company and is produced from a renewable source (within the meaning of paragraph (e)(1)(i)(C) of this section).

(C) For purposes of paragraph (e)(1)(i)(B) of this section, a utility is produced from a renewable source if—

(1) It is energy that is produced from energy property described in section 48;

(2) It is energy that is produced from a facility described in section 45(d)(1), (2), (3), (4), (6), (9), or (11); or

(3) It is a utility that is described in guidance published for this purpose in the Internal Revenue Bulletin (see §601.601(d)(2)(ii) of this chapter).

(D) Determinations under paragraphs (e)(1)(i)(C)(1) and (2) of this section take into account only the manner in which the energy is produced and not who owns the energy property or the facility or whether the applicability of relevant portions of sections 45 and 48 has expired.

* * * * *

(iv) * * *

(B) To the extent that the utility consumed is described in paragraph (e)(1)(i)(B) of this section, the utility rate charged to the tenants of the unit does not exceed the highest rate that the tenants would have paid if they had obtained the utility from a local utility company. In determining whether a rate satisfies the preceding sentence, a building owner may rely on the rates published by local utility companies.

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§1.42-10T [Removed]

Par. 5. Section 1.42-10T is removed.

Par. 6. Section 1.42-12 is amended by:

1. Revising paragraph (a)(5)(i)(E).

2. Revising paragraph (a)(5)(ii).

3. Adding paragraph (a)(5)(iii).

The revisions and addition read as follows:

§1.42-12 Effective dates and transitional rules.

(a) * * *

(5) * * *

(i) * * *

(E) Section 1.42-10(e), except as provided in paragraph (a)(5)(iii) of this section.

(ii) Except as provided in paragraph (a)(5)(iii) of this section, a building owner may apply the provisions described in paragraphs (a)(5)(i)(A) through (E) of this section to the building owner's taxable years beginning before March 3, 2016. Otherwise, the utility allowance provisions that apply to those taxable years are contained in §1.42–10, as contained in 26 CFR part 1, revised as of April 1, 2015.

(iii) The provisions in §1.42-10(e)(1)(i) introductory text, (e)(1)(i)(B) through (D), and (e)(1)(iv)(B) apply to a building owner's taxable years beginning on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. A building owner, however, may apply these provisions to earlier taxable years. Otherwise, the submetering provisions that apply to taxable years beginning after March 3, 2016, and before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, are contained in §1.42–10 and §1.42–10T as contained in 26 CFR part 1 revised as of April 1, 2016. In addition, a building owner may apply those submetering provisions to taxable years beginning before March 3, 2016.

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Kirsten Wielobob

Deputy Commissioner for Services and Enforcement.

Approved: February 26, 2019.

David J. Kautter

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2019-03827 Filed: 2/27/2019 4:15 pm; Publication Date: 3/4/2019]