

otherwise applicable PHA utility allowance, the lower rent must be in effect for rent due more than 90 days after the date of the local utility company estimate. This paragraph (c)(1) does not apply until the building has achieved 90 percent occupancy for a period of 90 consecutive days or by the end of the first year of the credit period, whichever is earlier.

(2) *Annual review.* A building owner must review at least annually the basis on which utility allowances have been established and must update the applicable utility allowance in accordance with paragraph (c)(1) of this section. The review must take into account any changes to the building such as any energy conservation measures that affect energy consumption and changes in utility rates.

**Par. 3.** Section 1.42-12 is amended by adding paragraph (a)(4) to read as follows:

**§ 1.42-12 Effective dates and transitional rules.**

(a) \* \* \*

(4) *Utility allowances.* Section 1.42-10 is applicable to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

\* \* \* \* \*

**Kevin M. Brown,**

*Deputy Commissioner for Services and Enforcement.*

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[REG-114084-04]

RIN 1545-BD20

**Section 42 Qualified Contract Provisions**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** Section 42(h)(6)(F) requires the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the provisions of section 42(h)(6)(F), including regulations to prevent the manipulation of the qualified contract amount. This document contains proposed regulations that provide guidance

concerning taxpayers' requests to housing credit agencies to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The regulations will affect taxpayers requesting a qualified contract, potential buyers, and low-income housing credit agencies responsible for the administration of the low-income housing credit program. This document also provides notice of a public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by September 17, 2007. Outlines of topics to be discussed at the public hearing scheduled for October 15, 2007, must be received by September 13, 2007.

**ADDRESSES:** Send submissions to: Internal Revenue Service, CC:PA:LPD:PR (REG-114084-04), room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-114084-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or may be sent electronically via the Federal eRulemaking Portal at: <http://www.regulations.gov> (IRS REG-114084-04). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Jack Malgeri (202) 622-3040; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Kelly Banks, (202) 622-7180 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Paperwork Reduction Act**

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of

information should be received by August 20, 2007.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in § 1.42-18(a)(1)(ii)(B). This information is required in order for a taxpayer to provide a written request to a housing credit agency to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The collection of information is voluntary to obtain a benefit. The likely respondents are business or other for-profit institutions.

*Estimated total annual reporting burden:* 20,000 hours.

*Estimated average annual burden hours per respondent:* 1 hour.

*Estimated number of respondents:* 20,000.

*Estimated annual frequency of responses:* One time.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

**Background**

This document contains amendments to 26 CFR part 1 under section 42 of the Internal Revenue Code (Code). Section 42 was amended by section 7108(c)(1) of the Omnibus Budget Reconciliation Act

of 1989 (Pub. L. 101-239, 103 Stat. 2106) to add paragraph (h)(6). In general, section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of the taxable year.

Section 42(h)(6)(B) provides in part that the term commitment means any agreement between the taxpayer and the low-income housing credit agency (Agency) that requires that the applicable fraction (as defined in section 42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the commitment, and that prohibits the eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit and any increase in the gross rent with respect to the unit not otherwise permitted under section 42.

Section 42(h)(6)(D) defines the term extended use period as the period beginning on the first day in the compliance period under section 42(i)(1) on which the building is part of a qualified low-income housing project and ending on the later of: (1) The date specified by the Agency in the commitment, or (2) the date which is 15 years after the close of the compliance period.

Section 42(h)(6)(E)(i)(II) provides for the termination of the extended use period if the Agency is unable to present within a specified period of time a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a low-income building.

Section 42(h)(6)(F) defines the term qualified contract as a bona fide contract to acquire (within a reasonable period of time after the contract is entered into) the non low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the commitment) of the sum of: (I) The outstanding indebtedness secured by, or with respect to the building, (II) the adjusted investor equity in the building, plus (III) other capital contributions not reflected in these amounts, reduced by cash distributions from (or available for distribution from) the project.

Section 42(h)(6)(F) also provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out that paragraph, including regulations to prevent the manipulation

of the amount determined under section 42(h)(6)(F).

Section 42(h)(6)(I) provides that the Agency must present the qualified contract within the 1-year period beginning on the date (after the 14th year of the compliance period) the taxpayer submits a written request to the Agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.

These proposed regulations provide guidance with respect to the application of the qualified contract provisions of section 42.

### Explanation of Provisions

#### *Qualified Contract Formula*

Section 1.42-18(c)(1) of the proposed regulations defines the qualified contract formula used to compute the purchase price amount of the low-income housing building as: (1) The fair market value of the non low-income portion of the building, plus (2) the low-income portion of the building. Section 1.42-18(c)(2) of the proposed regulations defines the low-income portion of the building as an amount not less than the applicable fraction (as specified in the commitment) of the total of: (a) Outstanding indebtedness on the building, plus (b) the adjusted investor equity in the building, plus (c) other capital contributions not reflected in the amounts in described in (a) and (b), minus (d) cash distributions from (or available for distribution from) the project.

Under § 1.42-18(b)(3) of the proposed regulations, the fair market value of the non low-income portion of the building is its fair market value at the time of the Agency's offer of sale. Because the intent of the extended-long term commitment is the continued use of the low-income portion of the building as low-income housing, the Treasury Department and IRS believe that fair market value must reflect the restrictions on the use of the low-income portion of the building. Therefore, the proposed regulations provide that the valuation must take into account the existing and continuing requirements under the commitment for the building.

Section 42(h)(6) does not discuss the appropriate treatment of land in the calculation of qualified contracts. Qualified contracts are defined by reference to the building, which for other purposes of section 42 generally does not include the underlying land. However, because the Treasury Department and the IRS anticipate that the sales of the building without the underlying land would be infrequent,

the Treasury Department and the IRS believe that it is necessary to include the underlying land in the computation of the qualified contract formula. Therefore, the proposed regulations provide that the non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion, regardless of whether the building is entirely low-income. Comments are requested on whether low-income buildings are ever sold without the underlying land, and if so, the appropriate treatment in those cases. In addition, comments are requested on the appropriate treatment of leased land and the prevalence of leased land in low-income housing credit transactions.

For purposes of determining the low-income portion of the building, § 1.42-18(c)(3) defines the term outstanding indebtedness as the outstanding principal balance, at the time of the sale, of any indebtedness or loan that is secured by, or with respect to, the building, and that does not exceed the amount of qualifying building costs. Qualifying building costs are generally defined in § 1.42-18(b)(4) of the proposed regulations as those costs that would have been includible in eligible basis of a low-income housing building under section 42(d)(1), provided the amounts were expended for depreciable property that conveys under the contract with the building. Thus, for example, the outstanding mortgage on the building will generally be outstanding indebtedness for purposes of section 42(h)(6)(F), even if the indebtedness is incurred after the first year of the credit period, but only up to the amount of costs included in original eligible basis established at the end of the first year of the credit period under section 42(f)(1), plus indebtedness for qualifying building costs incurred after the first year of the credit period of a type that could be includible in eligible basis under section 42(d)(1). Thus, any proceeds from refinancing indebtedness or additional mortgages in excess of such qualifying building costs are not outstanding indebtedness for purposes of section 42(h)(6)(F).

Outstanding indebtedness with an interest rate below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance must be discounted using a present-value calculation to obtain an imputed principal amount. This imputed principal amount constitutes the amount of indebtedness that must be utilized in calculating the amount of outstanding indebtedness under the qualified contract formula.

Section 1.42–18(c)(4) of the proposed regulations provides that adjusted investor equity includes only those cash investments by owners of the low-income building used for qualifying building costs. Investor equity is adjusted by a cost of living adjustment not to exceed five percent. The cost-of-living adjustment is determined under section 1(f)(3), substituting the language in section 1(f)(3)(B) with “the CPI for the base calendar year.” The base calendar year is the calendar year with or within which the first taxable year of the credit period ends. Thus, the cost-of-living adjustment is the percent by which the Consumer Price Index (CPI) for the year preceding the written request to find a person to acquire the project exceeds the CPI for the base calendar year.

Under § 1.42–18(c)(5) of the proposed regulations, other capital contributions are defined as contributions for qualifying building costs other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this section. An example of other capital contributions includes an amount expended to replace a furnace after the first year of the credit period, provided any loan taken to finance the furnace was not secured by the furnace or the building. In this example, the loan would be outstanding indebtedness on the building.

Qualifying building costs are defined under § 1.42–18(b)(4)(i) and (ii) of the proposed regulations. Under § 1.42–18(b)(4)(i) of the proposed regulations, a qualifying building is a cost included in eligible basis under section 42(d)(1). A cost is included in eligible basis under section 42(d)(1) only if the cost is (1) included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and § 1.103–8(b)(4)(iii), or (2) included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building, but only if the property conveys under the contract with the building. A qualifying building cost also includes costs incurred after the first year of the credit period (as defined in section 42(f)) of the type included in eligible basis under section 42(d)(1). See § 1.42–18(b)(4)(ii) of the proposed regulations.

Under the qualified contract formula, the sum of the outstanding indebtedness, adjusted investor equity, and other capital contributions is reduced by cash distributions from or available for distribution from the

project. Section 1.42–18(c)(6) of the proposed regulations defines cash distributions as including all distributions to owners or related parties within the meaning of section 267(b) or 707(b) (for example, cash distributions to owners from the proceeds of refinancings and second mortgages in excess of existing mortgages), and all cash and cash equivalents including reserve funds (for example, replacement and operating reserves) generated by cash flow from the project. To the extent an owner contributed his or her own funds to a reserve fund for replacement and improvements, such amounts are evaluated as either adjusted investor equity or other capital contributions. The Treasury Department and the IRS request comments and examples of forms of cash distributions from or available for distribution from the project that should or should not be included in the regulatory definition. Additionally, comments are requested whether low-income housing is owned by other than a corporation or partnership, for example, a sole proprietor, estate, or trust, and if so, what rules should apply for determining the amount of cash distributions from the project.

#### *Administrative Discretion and Responsibilities of Agency*

Under § 1.42–18(d)(1) of the proposed regulations, the Agency may exercise administrative discretion in evaluating and acting upon an owner’s request to find a buyer to acquire the building. For example, the Agency may determine that an owner’s request to find a buyer for the project lacks essential information and it may suspend the one-year period for finding a buyer until essential information is submitted.

#### *Actual Offer of Sale*

Section 1.42–18(d)(2) of the proposed regulations provides that in order to satisfy the qualified contract requirements under section 42(h)(6), the Agency must offer the building for sale to the general public at the determined qualified contract price upon receipt of a written request by the owner to find a buyer to acquire the building.

#### *Fair Market Value Cap*

Commentators suggested the inclusion of a fair market value cap on the low-income portion of the qualified contract amount as defined in section 42(h)(6)(F) noting that the qualified contract price may exceed the fair market value of a project. Commentators noted one reason for the qualified contract price exceeding fair market

value is the formula for adjusted investor equity, which includes the CPI-based cost of living adjustments. The statute defines a qualified contract, in part, as a contract to acquire the low-income portion of the building for an amount “not less than” the applicable fraction of the statutorily provided formula. Therefore, the proposed regulations do not adopt this comment. However, the flush language of section 42(h)(6)(E) provides that the qualified contract exception to the termination of the extended use period of a commitment shall not apply to the extent more stringent requirements are provided in the commitment or in state law. The Treasury Department and the IRS request comments on the extent of Agency and state authority in providing more stringent requirements than the provisions contained in section 42(h)(6)(F), and specifically, the authority of Agency or state regulators to require in agreements a fair market value cap that would restrict any qualified contract price to fair market value.

#### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information described under the heading “Paperwork Reduction Act” imposes virtually no incremental burden in time or expense and is voluntary for the taxpayer to obtain a benefit. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed

rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 15, 2007, beginning at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments on September 17, 2007 and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 13, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### Drafting Information

The principal author of these proposed regulations is Jack Malgeri, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### PART 1—INCOME TAXES

**Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order as follows:

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

Section 1.42–18 also issued under 26 U.S.C. 42(h)(6)(F) and 42(h)(6)(K); \* \* \*

**Par. 2.** Section 1.42–18 is added to read as follows:

#### § 1.42–18 Qualified contracts.

(a) *Extended low-income housing commitment*—(1) *In general.* No credit under section 42(a) is allowed by reason of section 42 and this section with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of such taxable year. A commitment must be in effect for the extended use period (as defined in paragraph (a)(1)(i) of this section).

(i) *Extended use period.* The term *extended use period* means the period beginning on the first day in the compliance period (as defined in section 42(i)(1)) on which the building is part of a qualified low-income housing project (as defined in section 42(g)(1)) and ending on the later of—

(A) The date specified by the low-income housing credit agency (Agency) in the commitment; or

(B) The date that is 15 years after the close of the compliance period.

(ii) *Termination of extended use period.* The extended use period under paragraph (a)(1)(i) of this section for any building will terminate—

(A) On the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period; or

(B) On the last day of the one-year period beginning on the date (after the 14th year of the compliance period) the owner submits a written request to the Agency to find a person to acquire the owner's interest in the low-income portion of the building and the Agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building (as defined in section 42(c)(2)). This paragraph (a)(1)(ii)(B) shall not apply to the extent more stringent requirements are provided in the commitment or under state law. If the Agency provides a qualified contract within the one-year period and the owner rejects or fails to act upon the contract, the building remains subject to the existing commitment.

(iii) *Eviction, gross-rent increase concerning existing low-income tenants not permitted.* During the three-year period following the termination of a commitment, no owner shall be permitted to evict or terminate the tenancy (other than for good cause) of an existing tenant of any low-income unit, or increase the gross rent for such

unit in a manner or amount not otherwise permitted by section 42.

(2) [Reserved]

(b) *Special rules.* For purposes of this section, the following terms are defined:

(1) *Base calendar year* means the calendar year with or within which the first taxable year of the credit period ends.

(2) *The low-income portion* of a building is the portion of the building equal to the applicable fraction (as defined in section 42(c)(1)) specified in the commitment for the building.

(3) *The fair market value* of the non low-income portion of the building is determined at the time of the Agency's offer of sale of the project to the general public. This valuation must take into account the existing and continuing requirements contained in the commitment for the building. The non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion regardless of whether the project is entirely low-income. The non low-income portion also includes the fair market value of items of personal property not included in eligible basis under section 42(d)(1) that convey under the contract with the building.

(4) *A qualifying building cost* is—

(i) A cost that is included in eligible basis of a low-income housing building under section 42(d)(1) which is—

(A) Included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and § 1.103–8(b)(4)(iii); or

(B) Included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building; and

(ii) Of the type described in paragraph (b)(4)(i) of this section incurred after the first year of the low-income building's credit period under section 42(f).

(c) *Qualified contract purchase price formula*—(1) *In general.* For purposes of this section, the term *qualified contract* means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the non low-income portion of the building for fair market value (as defined in paragraph (b)(3) of this section) and the low-income portion of the building (as defined in paragraph (b)(2) of this section) for the low-income portion amount as calculated in paragraph (c)(2) of this section. The qualified contract amount is determined at the time of the Agency's offer of sale of the project to the general public. An Agency must,

however, adjust the amount of the low-income portion of the qualified contract formula to reflect changes in the components of the qualified contract formula such as mortgage payments which reduce outstanding indebtedness between the time of the seller's request to the Agency to obtain a buyer and the project's actual sale closing date. In addition, the Agency may adjust the fair market value of the building if, after a reasonable period of time within the one-year offer of sale period, no buyer has made an offer or market values have adjusted downward.

(2) *Low-income portion amount.* The low-income portion amount is an amount not less than the applicable fraction specified in the commitment, as defined in section 42(h)(6)(B)(i), multiplied by the total of—

(i) The outstanding indebtedness for the building (as defined in paragraph (c)(3) of this section); plus

(ii) The adjusted investor equity in the building (as defined in paragraph (c)(4) of this section); plus

(iii) Other capital contributions (as defined in paragraph (c)(5) of this section), not including any amounts described in paragraphs (c)(2)(i) and (ii) of this section; minus

(iv) Cash distributions from (or available for distribution from) the building (as defined in paragraph (c)(6) of this section).

(3) *Outstanding indebtedness.* (i) For purposes of paragraph (c)(2)(i) of this section, except as provided in paragraph (c)(3)(ii) of this section, the term *outstanding indebtedness* for the building means the remaining stated principal balance, at the time of the Agency's offer of sale of the project to the general public, of any indebtedness secured by, or with respect to, the building that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. Examples of such indebtedness include certain mortgages and developer fee notes (excluding developer service costs not included in eligible basis). Outstanding indebtedness does not include debt used to finance nondepreciable land costs, syndication costs, legal and accounting costs, and operating deficit payments. The term *outstanding indebtedness* for the building only includes obligations that are indebtedness under general principles of Federal income tax law.

(ii) For purposes of paragraph (c)(2)(i) of this section, if the indebtedness had a yield to maturity below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance, the term *outstanding indebtedness* for the building is the imputed principal

amount of the indebtedness, secured by, or with respect to, the building, at the time of the Agency's offer of sale of the project to the general public, that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. The imputed principal amount of the indebtedness is the sum of the present values, as of the Agency's offer of sale of the project to the general public, of all the remaining payments of principal and interest payable on the indebtedness after the Agency's offer of sale of the project to the general public. The present value of each payment is determined by using a discount rate equal to the applicable Federal rate (as determined under section 1274(d)) at the time of issuance of the indebtedness. In the case of a variable rate debt instrument, rules similar to those in § 1.1274-2(f) are used to determine the instrument's imputed principal amount.

(4) *Adjusted investor equity.* (i) For purposes of paragraph (c)(2)(ii) of this section, the term *adjusted investor equity* for any calendar year means the aggregate amount of cash invested by owners for qualifying building costs described in paragraph (b)(4)(i) of this section. Thus, equity paid for land, credit adjuster payments, Agency low-income housing credit application and allocation fees, operating deficit contributions, and legal, syndication, and accounting costs all are examples of cost payments that do not qualify as adjusted investor equity under this section.

(ii) The adjusted investor equity as determined under paragraph (c)(4)(i) of this section is increased by an amount equal to the adjusted investor equity multiplied by the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting for the language in section 1(f)(3)(B), the Consumer Price Index for all urban consumers (CPI) (not seasonally adjusted, U.S. City Average) as specified in paragraph (c)(4)(v) of this section for the base calendar year (as defined in paragraph (b)(1) of this section).

(iii) Adjusted investor equity is taken into account under this section only to the extent there existed an obligation to invest the amount as of the beginning of the low-income building's credit period (as defined in section 42(f)(1)).

(iv) Adjusted investor equity does not include amounts included in the calculation of outstanding indebtedness as defined in paragraph (c)(3) of this section.

(v) *The cost-of-living adjustment* is based on the CPI as of the close of the 12-month period ending on August 31

of the calendar year. The *cost-of-living adjustment* is the percent by which the CPI for the year preceding the written request to find a person to acquire the taxpayer's project (CPI<sub>p</sub>) exceeds the CPI for the base calendar year (CPI<sub>b</sub>). If the CPI for any calendar year during this period (after the base calendar year) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under paragraph (c)(4) of this section. The adjusted investor equity equals the aggregate amount of cash invested by the taxpayer in the building multiplied by the ratio of CPI<sub>p</sub> to CPI<sub>b</sub>.

(vi) *Example.* The following example illustrates the CPI calculation:

*Example.* Owner contributed \$600,000 in equity to a building in 1991, which was the first year of the credit period for the project. In year 2005, owner requests Agency to find a buyer to purchase the building. The CPI<sub>b</sub> (at the close of the 12-month period ending on August 31, 1991) is 136.6. The CPI<sub>p</sub> for the close of the 12-month period ending August 31, 2004, is 189.5. At no time during this period (after the base calendar year) did the CPI for any calendar year exceed the CPI for the preceding calendar year by more than 5 percent. The owner's adjusted investor equity is \$600,000 multiplied by 189.5/136.6, or \$832,357.

(5) *Other capital contributions.* For purposes of paragraph (c)(2)(iii) of this section, other capital contributions to a low-income building are qualifying building costs described in paragraph (b)(4)(ii) of this section paid or incurred by the owner of the low-income building other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this section. For example, other capital contributions may include amounts incurred to replace a furnace after the first year of a low-income housing credit building's credit period under section 42(f), provided any loan used to finance the replacement of the furnace is not secured by the furnace or the building. Other capital contributions do not include expenditures for land costs, operating deficit payments, credit adjuster payments, and payments for legal, syndication, and accounting costs.

(6) *Cash distribution—(i) In general.* For purposes of paragraph (c)(2)(iv) of this section, the term *cash distributions* from (or available for distribution from) the project include—

(A) All distributions from the project to the owners or to related parties within the meaning of section 267(b) or section 707(b)), including distributions under section 301 (relating to distributions by a corporation), section

731 (relating to distributions by a partnership), or section 1368 (relating to distributions by a S corporation); and

(B) All cash and cash equivalents available for distribution at the time of sale, including for example, reserve funds whether operating or replacement reserves.

(ii) *Anti-abuse rule.* The Commissioner will interpret and apply the rules in this paragraph (c)(6) as necessary and appropriate to prevent manipulation of the qualified contract amount. For example, cash distributions include payments to owners or related parties within the meaning of section 267(b) or section 707(b) for any operating expenses in excess of amounts reasonable under the circumstances.

(d) *Administrative responsibilities of the Agency—(1) In general.* An Agency may exercise administrative discretion in evaluating and acting upon an owner's request to find a buyer to acquire the building. Examples of administrative discretion may include but are not limited to the following:

(i) Concluding that the owner's request lacks essential information and denying the request until such information is provided.

(ii) Refusing to consider an owner's representations without substantiating documentation verified with the Agency's records.

(iii) Suspending the one-year period for finding a buyer until the owner provides requested information.

(iv) Determining how many subsequent requests to find a buyer, if any, may be submitted if the owner has previously submitted a request for a qualified contract and then rejects or fails to act upon the qualified contract furnished by the Agency.

(v) Assessing and charging the seller certain administrative fees for the performance of services in obtaining a qualified contract (for example, real estate appraiser costs).

(vi) Requiring other conditions applicable to the qualified contract consistent with this section.

(2) *Actual offer.* Upon receipt of a written request from the owner to find a person to acquire the building, the Agency must offer the building for sale at the determined qualified contract amount to the general public in order for the qualified contract to satisfy the requirements of this section unless the Agency has already identified a willing buyer who submitted a contract to purchase the building.

(e) *Effective/applicability date.* This section is applicable on the date the

final regulations are published in the **Federal Register**.

**Kevin M. Brown,**

*Deputy Commissioner for Services and Enforcement.*

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## DEPARTMENT OF HOMELAND SECURITY

### Coast Guard

#### 33 CFR Part 165

[CGD14-07-001]

RIN 1625-AA87

#### Security Zones; Oahu, Maui, Hawaii, and Kauai, HI

**AGENCY:** Coast Guard, DHS.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Coast Guard proposes to change the permanent security zones in waters adjacent to the islands of Oahu, Maui, Hawaii, and Kauai, Hawaii. Review of the established zones indicates the need for some adjustment to better suit vessel and facility security in and around Hawaiian ports. The proposed changes are intended to enhance the protection of personnel, vessels, and facilities from acts of sabotage or other subversive acts, accidents, or other causes of a similar nature.

**DATES:** Comments and related material must reach the Coast Guard on or before July 19, 2007.

**ADDRESSES:** You may mail comments and related material to Commanding Officer, U.S. Coast Guard Sector Honolulu, Sand Island Parkway, Honolulu, Hawaii 96819-4398. Sector Honolulu maintains the public docket for this rulemaking. Comments and material received from the public, as well as documents indicated in this preamble as being available in the docket, are available for inspection and copying at Coast Guard Sector Honolulu between 7 a.m. and 3:30 p.m., Monday through Friday, except Federal holidays.

**FOR FURTHER INFORMATION CONTACT:** Lieutenant (Junior Grade) Jasmin Parker, U. S. Coast Guard Sector Honolulu at (808) 842-2600.

#### SUPPLEMENTARY INFORMATION:

##### Request for Comments

We encourage you to participate in this rulemaking by submitting comments and related material. If you do so, please include your name and address, identify the docket number for

this rulemaking (CGD14-07-001), indicate the specific section of this document to which each comment applies, and give the reason for each comment. Please submit all comments and related material in an unbound format, no larger than 8 1/2 by 11 inches, suitable for copying. If you would like to know that your submission reached us, please enclose a stamped, self-addressed postcard or envelope. We will consider all comments and material received during the comment period. We may change this proposed rule in view of them.

#### Public Meeting

We do not now plan to hold a public meeting. But you may submit a request for a meeting by writing to Sector Honolulu at the address under **ADDRESSES** explaining why one would be beneficial. If we determine that one would aid this rulemaking, we would hold one at a time and place announced by separate notice in the **Federal Register**.

#### Background and Purpose

The terrorist attacks against the United States that occurred on September 11, 2001, have emphasized the need for the United States to establish heightened security measures in order to protect the public, ports and waterways, and the maritime transportation system from future acts of terrorism or other subversive acts. The terrorist organization al-Qaeda and other similar groups remain committed to conducting armed attacks against U.S. interests, including civilian targets within the United States. National security and intelligence officials warn that future terrorist attacks are likely.

In response to this threat, on December 19, 2005, the Coast Guard published a final rule establishing permanent security zones in designated waters surrounding the Hawaiian Islands (70 FR 75036, December 19, 2005). These zones replaced the temporary zones that had been established, and then extended, in the waters surrounding the Hawaiian Islands soon after the attacks (66 FR 52693, October 17, 2001). The existing permanent security zones have been in operation for over a year.

We have recently completed a periodic review of port and harbor security procedures and considered the oral feedback that local vessel operators gave to Coast Guard units enforcing the zones. In response, the Coast Guard is proposing to reduce the scope of the *Honolulu International Airport, North Section* security zone. The Coast Guard is also proposing new zones at