
# Conquering LIHTC Utility Allowances

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To date in this series, we have discussed;

- Utility Allowance Basics
- HUD & RD Regulated Buildings
- Public Housing Authority Utility Allowance Schedule
- Utility Company Estimate
- Agency Estimate
- Submetering

In the sixth article of this series on Low-Income Housing Tax Credit (LIHTC) utility allowance requirements, we will be reviewing Submetering and Renewable Energy Sources.

## Submetering

Treasury Regulation 1.42-10 states that "*If the cost of any utility (other than telephone, cable television, or Internet) for a residential rental unit is paid directly by the tenant(s), and not by or through the owner of the building, the gross rent for that unit includes the applicable utility allowance determined under this section*."

Essentially, this means:

- If a tenant in a low-income unit pays for utilities directly to the utility provider, the gross rent calculation must include a utility allowance;
- If a building owner pays for utilities, there is no utility allowance;
- If the owner pays utilities directly and charges a fee (in addition to rent) to the resident for the utilities, there is no utility allowance; however, the fee would be considered a non-optional fee and therefore included in the gross rent calculation.

*But what about submetered units?*

Submetering occurs when a building's overall utility consumption is billed to the building owner, and the building owner bills the tenants for utilities based on the tenants' actual consumption using unit-based meters.

In 2009, the IRS issued Notice 2009–44, which clarified that tenant-paid utility costs based on actual consumption in a submetered LIHTC unit are treated as paid by the tenant directly to the utility company, not by or through the owner of the building. That means the gross rent is determined using the applicable utility allowance under 1.42-10 (b), and the amount paid by the tenant is not treated as a non-optional fee.

Notice 2009–44 also stipulated that if the owner/agent charges tenants a reasonable fee for the administrative costs of submetering, then the fee is not included when determining gross rent. The fee charged must not exceed an aggregate amount per unit of $5 per month (unless state law provides otherwise); however, this guidance was further clarified with the 2016 amendment.

In 2012 the IRS published proposed changes to Treas. Reg. 1.42-5 to incorporate the guidance in Notice 2009-44, with some revisions. These proposed regulations become final, and the regulations were amended on March 3, 2016. The 2016 amendment to Treas. Reg. 1.42-5 added section (e), which defined Submetering for purposes of complying with the utility allowance regulations.

> *Actual-consumption submetering arrangements — (1) Definition. For purposes of this section, an actual consumption submetering arrangement for a utility in a residential unit possesses all of the following attributes:*
>
> *(i) The utility consumed in the unit is described in paragraph (e)(1)(i)(A) of this section or in § 1.42–10T(e)(1)(i)(B);*
>
> *(A) The utility is purchased from or through a local utility company by the building owner (or its agent or other party acting on behalf of the building owner).*
>
> *(ii) The tenants in the unit are billed for, and pay the building owner (or its agent or other party acting on behalf of the building owner) for, the unit's consumption of the utility;*
>
> *(iii) The billed amount reflects the unit's actual consumption of the utility. In the case of sewerage charges, however, if the unit's sewerage charges are combined on the bill with water charges and the sewerage charges are determined based on the actual water consumption of the unit, then the bill is treated as reflecting the actual sewerage consumption of the unit; and*
>
> *(iv) The rate at which the building owner bills for the utility satisfies the following requirements:*
>
> *(A) To the extent that the utility consumed is described in paragraph (e)(1)(i)(A) of this section, the utility rate charged to the tenants of the unit does not exceed the rate incurred by the building owner for that utility; and*
>
> *(B) To the extent that the utility consumed is described in § 1.42– 10T(e)(1)(i)(B), the utility rate charged to the tenants of the unit does not exceed the rate described in § 1.42– 10T(e)(1)(iv)(B)*

The 2016 amendment further expanded the requirements that must be met in order for an administrative fee to be excluded from a unit's gross rent determination. The exclusion from gross rent does not apply unless:

- The fee is computed in the same manner for every unit receiving the same submetered utility service.
- The aggregate monthly fee or fees for all of the unit's utilities under one or more actual-consumption submetering arrangements does not exceed the greater of:
  1. $5 per month
  2. An amount (if any) designated by publication in the Internal Revenue Bulletin; or
  3. The lesser of
     - The dollar amount (if any) specifically prescribed under a State or local law; or
     - A maximum amount (if any) designated by publication in the Internal Revenue Bulletin

*Ration Utility Billing System*

A ration utility billing system (RUBS) is a type of system that uses a formula to allocate a property's utility costs based on certain factors such as the number of occupants and the size of the unit. Because RUBS is formula-based and not based on actual consumption, this type of system clearly does not meet the definition of "Actual Consumption Submetering Arrangements" under Treas. Reg. 1-42-10(e). That said, 1.42.10(e) does not preclude a building owner from using RUBS at a LIHTC project. An owner can still use RUBS, but no utility allowance would be included when determining the gross rent; instead, the amount charged to the tenant for utilities would be treated as a non-optional fee when determining gross rent.

## Renewable Energy Source

The 2016 amendment to Treas. Reg. 1.42-5 also included temporary regulations regarding energy that is obtained directly from a renewable energy source. The IRS realized when reviewing comments submitted regarding the 2012 proposed utility allowance regulations that the definition of "Actual Consumption Submetering Arrangements" under Treas. Reg. 1-42-10(e), technically excluded electricity generated from renewable sources by the owner or that the owner purchases directly from some other person.

To address the inadvertent exclusion, the 2016 amendment included temporary regulations that applied the submetering principles to renewable energy sources if the renewable energy source meets the requirements established by Treasury.

On March 4, 2019, the IRS published the final regulations. While the final regulations carry forward many of the requirements in the temporary regulations published in 2016, a few of the provisions were modified prior to being adopted in the final regulations.

### *Renewable Energy Source Qualification*

Per 1.42-10 (e)(1)(i), an energy source may qualify as a renewable energy source described in Section 48 or Section 45, even if the building owner does not actually qualify for or receive any credits under Section 48 or Section 45 for the renewable energy source. (See 1.42-10(e)(1)(i)(D))

The text of paragraph 1.42-10(e)(1)(i)(C) in the temporary regulations was unclear as to whether the owner of the energy source had to qualify for, or receive credit for, the energy source in order for the energy source to meet the requirements of the 1.42-10(e)(1)(i).

The final regulations provided clarification by adding paragraph (D) to 1.42-10(e)(1)(i), which states: "Determinations under (e)(1)(i)(C)(1) and (2) take into account only the manner in which the energy is produced and not who owns it or whether the applicable portions of sections 48 and 45 have expired."

### *Utility Rates*

When a renewable energy source is based on an actual-consumption submetering arrangement, and the rate requirement is met, the utility cost is treated as being paid directly by the tenant(s) and not by, or through, the owner of the building.

The temporary regulations stated that the utility rate charged to the tenants would meet the submetering requirements if the rate charged to tenants "is the rate at which the local utility company would have charged the tenants in the unit for the utility if that entity had provided it to them." This requirement did not provide enough information as to how building owners can demonstrate that the rate charged to tenants meets the requirements of 1.42-10(e)(1)(iv).

The final regulations provided clarification by amending the text of paragraph 1.42-10(e)(1)(iv)(B) to specify that the rate charged to the tenants cannot exceed the highest rate that the tenants would have paid for the utility from a local utility company.

*Please join me next quarter for the final installation of this series, which will cover Updating Utility Allowances & Record Retention.*

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