41. Credit for increasing research activities

(a) General rule. -- For purposes of section 38, the research credit determined under this section for the taxable year shall be an amount equal to the sum of --

(1) 20 percent of the excess (if any) of --

(A) the qualified research expenses for the taxable year, over

(B) the base amount, and

(2) 20 percent of the basic research payments determined under subsection (e)(1)(A).

(b) Qualified research expenses. -- For purposes of this section --

(1) Qualified research expenses. -- The term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer --

(A) in-house research expenses, and

(B) contract research expenses.

(2) In general. -- The term "in-house research expenses" means --

(i) any wages paid or incurred to an employee for qualified services performed by such employee,

(ii) any amount paid or incurred for supplies used in the conduct of qualified research, and

(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

Clause (iii) shall not apply to any amount to the extent that the taxpayer (or any person with whom the taxpayer must aggregate expenditures under subsection (f)(1)) receives or accrues any amount from any other person for the right to use substantially identical personal property.

(B) Qualified services. -- The term "qualified services" means services consisting of --

(i) engaging in the direct supervision or direct support of research activities which constitute qualified research.

If substantially all of the services performed by an individual for the taxpayer during the taxable year consists of services meeting the requirements of clause 9(i) or (ii), the term "qualified services" means all of the services performed by such individual for the taxpayer during the taxable year.

(C) Supplies. -- The term "supplies" means any tangible property other than --

(i) land or improvements to land, and

(ii) property of a character subject to the allowance for depreciation.

(D) Wages. --

(i) In general. -- The term "wages" has the meaning given such term by section 3401(a).

(ii) Self-employed individuals and owner-employees. -- In the case of an employee (within the meaning of section 401(c)(1)), the term "wages" includes the earned income (as defined in section 401(c)(2)) of such employee.

(iii) Exclusion for wages to which targeted jobs credit applies. --
The term "wages"shall not include any amount taken into account in determining the targeted jobs credit under section 51(a).

(3) Contract research expenses. --

(A) In general. -- The term "contract research expenses" means 65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

(B) Prepaid amounts. -- If any contract research expenses paid or incurred during any taxable year are attributable to qualified research to be conducted after the close of such taxable year, such amount shall be treated as paid or incurred during the period during which the qualified research is conducted.

(4) Trade or business requirement disregarded for in-house research expenses of certain startup ventures. -- In the case of in-house research expenses, a taxpayer shall be treated as meeting the trade or business requirement of paragraph (1), if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business --

(A) of the taxpayer, or

(B) of 1 or more other persons who with the taxpayer are treated as a single taxpayer under subsection (f)(1).

(c) Base amount. --

(1) In general.-- The term "base amount" means the product of --

(A) the fixed-base percentage, and

(B) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined (hereinafter in this subsection referred to as the "credit year").

(2) Minimum base amount. -- In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

(3) Fixed-base percentage. --

(A) In general. -- Except as otherwise provided in this paragraph, the fixed-base percentage is the percentage which the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 19890, is of the aggregate gross receipts of the taxpayer for such taxable years.

(B) Start-up companies. --

(i) taxpayers to which subparagraph applies. -- The fixed-base percentages shall be determined under this subparagraph if there are fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses.

(ii) Fixed-base percentage. -- In a case to which this subparagraph applies, the fixed-base percentage is 3 percent.

(iii) treatment of de minimize amounts of gross receipts and qualified research expenses. -- The Secretary may prescribe regulations providing that de minimis amounts of gross receipts

and qualified research expenses shall be disregarded under clause (i).

(C) Maximum fixed-base percentage. -- In no event shall the fixed-base percentage exceed 16 percent.

(D) Rounding. -- The percentages determined under subparagraph (A) shall be rounded to the nearest 1/100 of 1 percent.

(4) Consistent treatment of expenses required. --

(A) In general. -- Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expenses of the credit year.

(B) Prevention of distortions. -- The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in computing such taxpayer's fixed-base percentage.

(5) Gross receipts. -- For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States.

(d) Qualified research defined. -- For purposes of this section --

(1) In general. -- The term "qualified research" means research --

(A) with respect to which expenditures may be treated as expenses under section 174,

(B) which is undertaken for the purpose of discovering information --

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

(2) Tests to be applied separately to each business component. -- For purposes of this subsection --

(A) In general. -- Paragraph (1) shall be applied separately with respect to each business component of the taxpayer.

(B0 Business component defined. -- The term "business component" means any product, process, computer software, technique, formula, or invention which is to be --

(i) held for sale, lease, or license, or

(ii) used by the taxpayer in a trade or business of the taxpayer.

(C) Special rule for production processes. -- Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).

(3) Purposes for which research may qualify for credit. -- For purposes of paragraph (1)(C) --

(A) In general. -- Research shall be treated as conducted for a purpose described in this paragraph if it relates to --

(i) a new or improved function,

(ii) performance, or

(iii) reliability or quality.

(B) Certain purposes not qualified. -- Research shall in no event be treated as conducted for a purpose described in this paragraph if it relates to style, taste, cosmetic, or seasonal design factors.

(4) Activities for which credit not allowed. -- The term "qualified research" shall not include any of the following:

(A) Research after commercial production. -- Any research conducted after the beginning of commercial production of the business component.

(B) Adaptation of existing business components. -- Any research related to the adaptation of an existing business component of a particular customer's requirement or need.

(C) Duplication of existing business component. -- Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

(D) Surveys, studies, etc. -- Any --

(i) efficiency survey,

(ii) activity relating to management function or technique,

(iii) market research, testing, or development (including advertising or promotions),

(iv) routine data collection, or

(v) routine ordinary testing or inspection for quality control.

(E) Computer software. -- Except to the extent provided in regulations, any research with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer, other than for use in --

(i) an activity which constitutes qualified research (determined with regard to this subparagraph), or

(ii) a production process with respect to which the requirements of paragraph (1) are met.

(F) Foreign research. -- Any research conducted outside the United States.

(G) Social sciences, etc. -- Any research in the social sciences, arts, or humanities.

(H) Funded research. -- Any research to the extent funded by any grant, contract or otherwise by another person (or governmental entity).

(e) Credit allowable with respect to certain payments to

qualified organizations for basic research. -- For purposes of this section --

(1) In general. -- In the case of any taxpayer who makes basic research payments for any taxable year --

(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal tothe excess of --

(i) such basic research payments, over

(ii) the qualified organization base period amount,and

(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1).

(2) basic research payments defined. -- For purposes of this subsection --

(A) In general. -- The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if --

(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

(ii) such basic research is to be performed by such qualified organization.

(B) Exception to requirement that research be performed by the organization. -- In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (6), clause (ii) of subparagraph (A) shall not apply.

(3) Qualified organization base period amount. -- For purposes of this subsection, the term "qualified organization base period amount" means an amount equal to the sum of --

(A) the minimum basic research amount, plus

(B) the maintenance-of-effort amount.

(4) Minimum basic research amount. -- For purposes of this subsection --

(A) In general. -- The term "minimum basic research amount" means an amount equal to the greater of --

(i) 1 percent of the average of the sum of amounts paid or incurred during the base period for --

(I) any in-house research expenses, and

(II) any contract research expenses, or

(ii) the amounts treated as contract research expenses during the base period by reason of this subsection(as in effect during the base period).

(B) Floor amount. -- Except in the case of a taxpayer which was in existence during a taxable year (other than a short taxable year) in the base period, the minimum basic research amount for any base period shall not be less than 50 percent of the basic research payments for the taxable year for which a determination is being made under this subsection.

(5) Maintenance-of-effort amount. -- For purposes of this subsection --

(A) In general. -- The term "maintenance-of-effort amount" means, with respect to any taxable year, an amount equal to the excess (if any) of --

(i) an amount equal to --

(I) the average of the non designated university contributions paid by the taxpayer during the base period, multiplied by

(II) the cost-of-living adjustment for the calendar year in which such taxable year begins, over

(ii) the amount of non designated university contributions paid by the taxpayer during such taxable year.

(B) Non designated university contributions. -- For purposes of this paragraph, the term "non designated university contribution" means any amount paid by a taxpayer to any qualified organization described in paragraph (6)(A) --

(i) for which a deduction was allowable under section 170, and

(ii) which was not taken into account --

(I) in computing the amount of the credit under this section (as in effect during the base period) during any taxable year in the base period, or

(II) as a basic research payment for purposes of this section.

(C) Cost-of-living adjustment defined. --

(i) In general. -- the cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(f)(3), by substituting "calendar year 1987" for calendar year 1989" in subparagraph (B) thereof.

(ii) Special rule where base period ends in a calendar year other than 1983 or 1984. -- If the base period of any taxpayer does not end in 1983 or 1984, section 1(f)(3)(B) shall, for purposes of this paragraph, be applied by substituting the calendar year in which such base period ends for 1989. Such substitution shall be in lieu of the substitution under clause (i).

(6) Qualified organization. -- For purposes of this subsection, the term "qualified organization" means any of the following organizations:

(A) Educational institutions. -- Any education organization which --

(i) is an institution of higher education (within the meaning of section 3304(f)), and

(ii) is described in section 170(b)(1)(A)(ii).

(B) certain scientific research organizations. -- Any organization not described in subparagraph (A) which --

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a).

(ii) is organized and is operated primarily to conduct scientific research, and

(iii) is not a private foundation.

(C) Scientific tax-exempt organizations. -- Any organization which --

(i) is describe in --

(I) section 501(c)(3) 9other than a private foundation), or

(II) section 501(c)(6),

(ii) is exempt from tax under section 501(a),

(iii) is organized and operated primarily to promote

scientific research by qualified organizations described in subparagraph (A) pursuant to written research agreements, and

(iv) currently expends --

(I) substantially all of its funds, or

(II) substantially all of the basic research payments received by it,'for grants to, or contracts for basic research with, an organization described in subparagraph (A).

(D) Certain grant organizations. -- Any organization not descried in subparagraph (B) or (C) which --

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) (other than a private foundation),

(ii) is established and maintained by an organization established before July 10, 1981, which meets the requirements of clause (i),

(iii) is organized and operated exclusively for the purpose of making grants to organizations described in subparagraph (A) pursuant to written research agreements for purposes of basic research, and

(iv) makes an election, revocable only with the consent of the Secretary, to be treated as a private foundation for purposes of this title (other than section 4940, relating to excise tax based on investment income).

(7) Definitions and special rules. -- For purposes of this subsection --

(A) Basic research. -- The term "basic research" means any original investigation for the advancement of scientific knowledge not having a specific commercial objective, except that such term shall not include --

(i) basic research conducted outside of the United States, and

(ii) basic research in the social sciences, arts,or humanities.

(B) Base period. -- The term "base period"means the 3-taxable-year period ending with the taxable year immediately preceding the 1st taxable year of the taxpayer beginning after December 1, 1983.

(C) Exclusion from incremental credit calculation. -- For purposes of determining the amount of credit allowable under subsection (a)(1) for any taxable year, the amount of the basic research payments not taken into account under subsection (a)(2) --

(i) shall not be treated as qualified research expenses under subsection (a)(1)(B).

(D) trade or business qualification. -- For purposes of applying subsection (b)(1) to this subsection, any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of subsection (b)(3)(B)).

(E) Certain corporations not eligible. -- The term "corporation" shall not include --

(i) an S corporation,

(ii) a personal holding company (as defined in section 542), or

(iii) a service organization (as defined in section 414 (m)(3)).

(f) Special rules. -- For purposes of this section --

(1) Aggregation of expenditures. --

(A) Controlled group of corporations. -- In determining the amount of the credit under this section --

(i) all members of the same controlled group of corporations shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such member shall be its proportionate shares of the qualified research expenses and basic research payments giving rise to the credit.

(B) Common control. -- Under regulations prescribed by the Secretary, in determining the amount of the credit under this section --

(i) all trades or businesses (whether or not incorporated) which are under common control shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such person shall be its proportionate shares of the qualified research expenses and basic research payments giving rise to the credit.

The regulations prescribed under this subparagraph shall be based on principles similar to the principles which apply in the case of subparagraph (A).

(2) Allocations. --

(A) Pass-thru in the case of estates and trusts. -- Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

(B) Allocation in the case of partnerships. -- In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

(3) Adjustments for certain acquisitions, etc. -- Under regulations prescribed by the Secretary --

(A) Acquisitions. --- If, after December 31, 1983, a taxpayer acquires the major portion of a trade or business of another person (hereinafter in this paragraph referred to as the "predecessor") or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section for any taxable year ending after such acquisition, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such acquisition shall be increased by so much of such expenses paid or incurred by the predecessor with respect to the acquired trade or business as is attributable to the portion of such trade or business or separate unit acquired by the taxpayer, and the gross receipts of the taxpayer for such period shall be increased by so much of the gross receipts of such predecessor with respect tothe acquired trade or business as is attributable to such portion.

(B) Dispositions. -- If, after December 31, 1983 --

(i) a taxpayer disposes of the major portion of any trade or business or the major portion of a separate unit of a trade or business in a transaction to which subparagraph (A) applies, and

(ii) the taxpayer furnished the acquiring person such

information as is necessary for the application of subparagraph (A),
then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such disposition shall be decreased by so much of such expenses as is attributable to the portion of such trade or business or separate unit disposed of by the taxpayer, and the gross receipts of the taxpayer for such periods shall be decreased by so much of the gross receipts as is attributable to such portion.

(C) Certain reimbursements taken into account in determining fixed-base percentage. -- If during any of the 3 taxable years following the taxable year in which a disposition to which subparagraph (B) applies occurs, the disposing taxpayer (or a person with whom the taxpayer is required to aggregate expenditures under paragraph (1)) reimburses the acquiring person (or a person required to so aggregate expenditures with such person) for research on behalf of the taxpayer, then the amount of qualified research expenses of the taxpayer for the taxable years taken into account in computing the fixed-base percentage shall be increased by the lesser of --

(i) the amount of the decrease under subparagraph (B) which is allocable to taxable years so taken into account, or

(ii) the product of the number of taxable years so taken into account multiplied by the amount of the reimbursement described in the subparagraph.

(4) Short taxable years. -- In the case of any short taxable year, qualified research expenses and gross receipts shall be annualized in such circumstances and under such methods as the Secretary may prescribe by regulation.

(5) Controlled group of corporations. -- The term "controlled group of corporations" has the same meaning given to such term by section 15639a), except that --

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and

(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

(g) Special rule for pass-thru of credit. -- In the case of an individual who --

(1) owns an interest in an unincorporated trade or business,

(2) is a partner in a partnership,

(3) is a beneficiary of an estate or trust, or

(4) is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity. If the amount determined under subsection (a) for any taxable year exceeds the limitation of the preceding sentence, such amount may be carried to other taxable years under the rules of section 39; except that the limitation of the preceding sentence shall be

taken into account in lieu of the limitation of section 38(c) in applying section 39.

(h) Termination. --

(1) In general. -- this section shall not apply to any amount paid or incurred after June 30, 1992.

(2) Computation of base amount. -- In the case of any taxable year which begins before July 1, 1992, and ends after June 30, 1992, the base amount with respect to such taxable year shall be the amount which bears the same ratio to the base amount for such year (determined without regard to this paragraph) as the number of days in such taxable year before July 1, 1992, bears to the total number of days in such taxable year.

42. Low-income housing credit

(a) In general. For purposes of section 38, the amount of the low-income housing credit determined under this section for any taxable year in the credit period shall be an amount equal to --

(1) the applicable percentage of

(2) the qualified basis of each qualified low-income building.

(b) Applicable percentage: 70 percent present value credit for certain new buildings; 30 percent present value credit for certain other buildings. -- For purposes of this section --

(1) Building placed in service during 1987. -- In the case of any qualified low-income building placed in service by the taxpayer during 1987, the term "applicable percentage" means --

(A) 9 percent for new buildings which are not federally subsidized for the taxable year, or

(B) 4 percent for --

(i) new buildings which are federally subsidized for the taxable year, and

(ii) existing buildings.

(2) Buildings placed in service after 1987. --

(A) In general. -- In the case of any qualified low-income building placed in service by the taxpayer after 1987, the term applicable percentage means the appropriate percentage prescribed by the Secretary for the earlier of --

(i) the month in which sub building is placed in service, or

(ii) at the election of the taxpayer --

(I) the month in which the taxpayer and the housing credit agency enter in to an agreement with respect to such building (which is binding on such agency, the taxpayer, and all successors in interest) as to the housing credit dollar amount to be allocated to such building, or

(II) in the case of any building to which subsection (h)(4)(B) applies, the month in which the tax-exempt obligations are issued.

A month may be elected under clause (ii) only if the election is made not later than the 5th day after the close of such month. Such an election, once made, shall be irrevocable.

(B) Method of prescribing percentages. -- The percentages prescribed by the Secretary for any month shall be percentages which will yield over a 10-year period amounts of credit under subsection (a) which have a present value equal to --

(i) 70 percent of the qualified basis of a building described in paragraph (1)(A), and

(ii) by using a discount rate equal to 72 percent of the average of the annual Federal mid-term rate and the annual Federal long-term rate applicable under section 1274(d)(1) to the month applicable under clause (i) or (ii) of subparagraph (A) and compounded annually, and
(iii) by assuming that the credit allowable under this section for any year is received on the last day of such year.
(c) Qualified basis; qualified low-income building. -- For purposes of this section --
(1) Qualified basis. --
(A) Determination. -- The qualified basis of any qualified low-income building for any taxable year is an amount equal to --
(i) the applicable refraction (determined under subsection (d)(5)).
(B) Applicable fraction. -- For purposes of subparagraph (A), the term "applicable fraction" means the smaller of the unit fraction or the floor space fraction.
(C) Unit fraction. -- For purposes of subparagraph (B), the term "unit fraction" means the fraction --
(i) the numerator of which is the number of low-income units in the building, and
(ii) the denominator of which is the number of residential rental units (whether or not occupied) in such building.
(D) Floor space fraction. -- For purposes of subparagraph (B), the term "floor space fraction" means the fraction --
(i) the numerator of which is the total floor space of the low-income units in such building, and
(ii) the denominator of which is the total floor space of the residential rental units (whether or not occupied) in such building.
(E) Qualified basis to include portion of building used to provide supportive services for homeless. -- In the case of a qualified low-income building described in subsection (i)(3)(B)(iii), the qualified basis of such building for any taxable year shall be increased by the lesser of --
(i) so much of the eligible basis of such building as is used throughout the year to provide supportive services designed to assist tenants in locating and retaining permanent housing, or
(ii) 20 percent of the qualified basis of such building (determined without regard to this subparagraph).
(2) Qualified low-income building. -- The term "qualified low-income building" means any building --
(A) which is part of a qualified low-income housing project at all times during the period --
(i) beginning on the 1st day in the compliance period on which such building is part of such a project, and
(ii) ending on the last day of the compliance period with respect to such building, and
(B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.
Such term does not include any building with respect to which moderate rehabilitation assistance is provided, at any time during the compliance period, under section 8(e)(2) of the United States Housing Act of 1937 (other than assistance under the

Stewart B. McKinley Homeless Assistance Act of 1988 (as in effect on the date of the enactment of this sentence)).
(d) Eligible basis. -- For purposes of this section --
(1) New buildings. __ The eligible basis of a new building is its adjusted basis as of the close of the 1st taxable year of the credit period.
(2) Existing buildings. --
(A) In general. -- The eligible basis of an existing building is --
(i) in the case of a building which meets the requirements of subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and
(ii) zero in any other case.
(B) Requirements. -- A building meets the requirements of this subparagraph if --
(i) the building is acquired by purchase (as defined in section 179(d)(2)),
(ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the later of --
(I) the date the building was last placed in service, or
(II) the date of the most recent non qualified substantial improvement of the building,
(iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service, and
(iv) except as provided in subsection (f)(5), a credit is allowable under subsection (a) by reason of subsection (e) with respect to the building.
(C) Adjusted basis. -- For purposes of subparagraph (A), the adjusted basis of any building shall not include so much of the basis of such building as is determined by reference to the basis of other property held at any time by the person acquiring the building.
(D) Special rules for subparagraph (B). --
(i) Non qualified substantial improvement. -- For purposes of subparagraph (B)(ii) --
(I) IN general. -- The term "nonqualified substantial improvement" means any substantial improvement if section 167(k) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) was elected with respect to such improvement or section 168 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) applied to such improvement.
(II) Date of substantial improvement. -- The date of a substantial improvement is the last day of the 24-month period referred to in subclause (III).
(III) Substantial improvement. -- The term "substantial improvement" means the improvements added to capital account with respect to the building during any 24-month period, but only if the sum of the amounts added to such account during such period equals or exceeds 25 percent of the adjusted basis of the building (determined without regard to paragraphs (2) and (3) of section 1016(a)) as of the 1st day of such period.
(ii) Special rules for certain transfers. -- For purposes of determining under subparagraph (B)(ii) when a building was last

placed in service, there shall not be taken into account any placement in service --
(I) in connection with the acquisition of the building in a transaction in which the basis of the building in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such building in the hands of the person from whom acquired,
(II) by a person whose basis in such building is determined under section 1014(a) (relating to property acquired from a descendent),
(III) by any governmental unit or qualified nonprofit organization (as defined in subsection (h)(5)) if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such unit or organization and all the income from such property is exempt form Federal income taxation,
(IV) by any person who acquired such building by foreclosure (or by instrument in lieu of foreclosure) of any purchase-money security interest held by such person if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such person and such building is resold within 12 months after the date such building is placed in service by such person after such foreclosure, or
(V) of a single-family residence by any individual who owned and used such residence for no other purpose than as his principal residence.
(iii) Related person, etc. --
(I) Application of section 179. -- For purposes of subparagraph (B)(i), section 179(d) shall be applied by substituting "10 percent" for "50 percent" in section 267(b) and 707(b) and in section 179(b)(7).
(II) Related person. -- For purposes of subparagraph (B)(iii), a person (hereinafter in this subclause referred to as the "related person") is related to any person if the related person bears a relationship to such person specified in section 267(b) or 707 (b)(1), or the related person and such person are engaged in trades or businesses under common control (within the heading of subsections (a) and (b) of section 52). For purpose of the preceding sentence, in applying section 267(b) or 707(b)(1), "10 percent" shall be substituted for "50 percent".
(3) Eligible basis reduced where disproportionate standards for units. --
(A) In general -- Except as provided in subparagraph (B), the eligible basis of any building shall be reduced by an amount equal to the portion of the adjusted basis of the building which is attributable to residential rental units in the building which are not low-income units and which are above the average quality standard of the low-income units in the building.
(B) Exception where taxpayer elects to exclude excess costs. --
(1) In general. -- Subparagraph (A) shall not apply with respect to a residential rental unit in a building which is not a low-income unit if --
(I) the excess described in clause (ii) with respect to such unit is not greater than 15 percent of the cost described in clause (ii)(II), and

(II) the taxpayer elects to exclude from the eligible basis of such building the excess described in clause (ii) with respect to such unit.
(ii) Excess. -- The excess described in this clause with respect to any unit is the excess of --
(I) the cost of such unit, over
(II) the amount which would be the cost of such unit if the average cost per square foot of low-income units in the building were substituted for the cost per square foot of such unit.
The Secretary may be regulation provide for the determination of the excess under this clause on a basis other than square foot costs.
(4) Special rules relating to determination of adjusted basis. -- For purposes of this subsection --
(A) In general. -- Except as provided in subparagraph (B), the adjusted basis of any building shall be determined without regard to the adjusted basis of any property which is not residential rental property.
(B) Basis of property in common areas, etc., included. -- The adjusted basis of any building shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation) used in common areas or provided as comparable amenities to all residential rental units in such building.
(C) No reduction for depreciation. -- The adjusted basis of any building shall be determined without regard to paragraphs (2) and (3) of section 1016(a).
(5) Special rules for determining eligible basis. --
(A) Eligible basis reduced by federal grants. -- If, during any taxable year of the compliance period, a grant is made with respect to any building or the operation thereof and any potion of such grant is funded with Federal funds (whether or not includable in gross income), the eligible basis of such building for such building for such taxable year and all succeeding taxable e years shall be reduced by the potion of such grant which is so funded.
(B) Eligible basis not to include expenditures where section 167 (k) elected. -- The eligible basis of any building shall not include any portion of its adjusted basis which is attributable to amounts with respect to which an election is made under section 167(k) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).
(C) Increase in credit for buildings in high cost areas. --
(i) In general. -- In the case of any building located in a qualified census tract or difficult development area which is designated for purposes of this subparagraph --
(I) in the case of a new building, the eligible basis of such building shall be 130 percent of such basis determined without regard to this subparagraph, and
(II) in the case of an existing building, the rehabilitation expenditures taken into account under subsection (e) shall be 130 percent of such expenditures determined without regard to this subparagraph.
(ii) Qualified census tract. --

(I) In general. -- The term "qualified census tract" means any census tract which is designated by the Secretary of Housing and Urban Development and, for the most recent year for which census data are available on household income in such tract, in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income. If the Secretary of Housing and Urban Development determines that sufficient data for any period are not available to apply this clause on the basis of census tracts, such Secretary shall apply this clause for such period on the basis of enumeration districts.
(II) Limit on MSA's designated. -- Th portion of a metropolitan statistical area which may be designated for purposes of this subparagraph shall not exceed an area having 20 percent of the population of such metropolitan statistical area.
(III) Determination of areas. -- For purposes of this clause, each metropolitan statistical area shall be treated as a separate area and all non metropolitan areas in a State shall be treated as 1 area.
(iii) Difficult development areas. --
(I) In general. -- The term "difficult development areas" means any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.
(II) Limit on areas designated. -- The portions of metropolitan statistical areas which may be designated for purposes of this subparagraph shall not exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule shall apply to non metropolitan areas.
(iv) Special rules and definitions. -- For purposes of this subparagraph --
(I) population shall be determined on the basis of the most recent decennial census for which data are available,
(II) area median gross income shall be determined in accordance with subsection(g)(4),
(III) the term "metropolitan statistical area" has the same meaning as when used in section 143(k)(2)(B), and
(IV) the term "non metropolitan area" means any county (or portion thereof) which is not within a metropolitan statistical area.
(6) Credit allowable for certain federally-assisted buildings acquired during 10-year period described in paragraph (2)(B)(ii) . --
(A) In general. -- On application by the taxpayer, the Secretary (after consultation with the appropriate Federal official) may waive paragraph (2)(B)(ii) with respect to any federally-assisted building if the Secretary determines that such waiver is necessary --
(i) to avert an assignment of the mortgage secured by property in the project (of which such building is a part) to the Department of Housing and Urban Development or the Farmers Home Administration, or
(ii) to avert a claim against a Federal mortgage insurance fund (or such Department or Administration) with respect to a mortgage which is so secured.

The preceding sentence shall not apply to any building described in paragraph (7)(B).
(B) Federally-assisted building. -- For purposes of subparagraph (A), the term "federally-assisted building" means any building which is substantially assisted, financed, or operated under --
(i) section 8 of the United States Housing Act of 1937,
(ii) section 221(d)(3) or 236 of the National Housing Act, or
(iii) section 515 of the Housing Act of 1949,
as such Acts are in effect on the date of the enactment of the tax Reform Act of 1986.
(C) Low-income buildings where mortgage may be prepaid. -- A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to a federally-assisted building described in clause (ii) or (iii) of subparagraph (B) if --
(i) the mortgage on such building is eligible for prepayment under subtitle B of the Emergency Low Income Housing Preservation Act of 1987 or under section 502(c) of the Housing Act of 1949 at any time within 1 year after the date of the application for such a waiver,
(ii) the appropriate Federal official certifies to the Secretary that it is reasonable to expect that, if the waiver is not granted, such building will cease complying with its low-income occupancy requirements, and
(iii) the eligibility to prepay such mortgage without the approval of the appropriate Federal official is waived by all persons who are so eligible and such waiver is binding on all successors of such persons.
(D) Buildings acquired from insured depository institutions in default. -- A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to any building acquired from an insured depository institution in default (as defined in section 3 of the Federal Deposit Insurance Act) or from a receiver or conservator of such an institution.
(E) Appropriate federal official. -- For purposes of subparagraph (A), the term "appropriate Federal official" means --
(i) the Secretary of Housing and Urban Development in the case of any building described in subparagraph (B) by reason of clause (i) or (ii) thereof, and
(ii) the Secretary of Agriculture in the case of any building described in subparagraph (B) by reason of clause (iii) thereof.
(7) Acquisition of building before end of prior compliance period. --
(A) In general. -- Under regulations prescribed by the Secretary, in the case of a building described in subparagraph (B) (or interest therein) which is acquired by the taxpayer --
(i) paragraph (2)(B) shall not apply, but
(ii) the credit allowable by reason of subsection (a) to the taxpayer for any period after such acquisition shall be equal to the amount of credit which would have been allowable under subsection (a) for such period to the prior owner referred to in subparagraph (B) had such owner not disposed of the building.
(B) Description of building. -- A building is described in this subparagraph if --

(i) a credit was allowed by reason of subsection (a) to any prior owner of such building, and
(ii) the taxpayer acquired such building before the end of the compliance period for such building with respect to such prior owner (determined without regard to any disposition by such prior owner).
(e) Rehabilitation expenditures treated as separate new building. --
(1) In general. -- Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of this section as a separate new building.
(2) Rehabilitation expenditures. -- For purposes of paragraph 91) --
(A) In general. -- The term "rehabilitation expenditures" means amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building.
(B) Cost of acquisition, etc, not included. -- Such term does not include the cost of acquiring any building (or interest therein) or any amount not permitted to be taken into account under paragraph (3) or (4) of subsection (d).
(3) Minimum expenditures to qualify.--
(A) In general. -- Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if --
(i) the expenditures are allocable to 1 or more low-income units or substantially benefit such units, and
(ii) the amount of such expenditures during any 24-month period meets the requirements of which ever of the following subclauses requires the greater amount of such expenditures:
(I) the requirement of this subclause is met if such amount is not less than 10 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).
(II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is $3,000 or more.
(B) Exception from 10 percent rehabilitation. -- In the case of a building acquired by the taxpayer from a governmental unit, at the election of the taxpayer, subparagraph (A)(ii)(I) shall not apply and the credit under this section for such rehabilitation expenditures shall be determined using the percentage applicable under subsection (b)(2)(B)(ii).
(C) Date of determination. -- The determination under subparagraph (A) shall be made as of close of the 1st taxable year in the credit period with respect to such expenditures.
(4) Special rules. -- For purposes of applying this section with respect to expenditures which are treated as a separate building by reason of this subsection --
(A) such expenditures shall be treated as placed in service at the close of the 24-month period referred to in paragraph (3)(A) , and
(B) the applicable fraction under subsection (c)(1) shall be the applicable fraction for the building (without regard to paragraph (1)) with respect to which the expenditures were incurred.

Nothing in subsection (d)(2) shall prevent a credit from being allowed by reason of this subsection.

(5) No double counting. -- Rehabilitation expenditures may, at the election of the taxpayer, be taken into account under this subsection or subsection (d)(2)(A)(i) but not under both such subsections.

(6) Regulations to apply subsection with respect to group of units in building. -- The Secretary may prescribe regulations, consistent with the purposes of this subsection, treating a group of units with respect to which rehabilitation expenditures are incurred as a separate new building.

(f) Definition and special rules relating to credit period. --