

Novogradac Journal of Tax Credits

News, Analysis and Commentary On Affordable Housing, Community Development and Renewable Energy Tax Credits

July 2010, Volume I, Issue VII

Published by Novogradac & Company LLP

Project-Based v. County-Based Approach for Determining Income Limits

By James R. Kroger, CPA, Novogradac & Company LLP

This article is a follow up to the article, "Understanding the 2010 Income Limits," in the June 2010 Novogradac Journal of Tax Credits. Last month we described examples of the project-based approach versus the county-based approach for determining rent and income limits for low-income housing tax credit (LIHTC) and tax-exempt bond projects. Those examples showed how the project-based approach can result in counties with several rent and income limits. This poses technical challenges in determining which rent and income limits are correct for a project and practical challenges in having different rent and income limits for projects in the same area. This article will explore more issues related to the project-based approach.

The Internal Revenue Service (IRS) and the U.S. Department of Housing & Urban Development (HUD) have informally indicated that the project-based approach is the correct approach; however, the language in Internal Revenue Code (IRC) §42 and §142, along with the Housing and Economic Recovery Act of 2008 (HERA), isn't clear that a project-based approach is the absolute approach.

Background

Since 1986, LIHTC and tax-exempt bond properties under IRC §42 and §142 have determined their income limits from HUD Section 8 income limits. However, in 2009, to accommodate adjustments to the HERA required Section 8 income limits, HUD published income limits for IRC §42 and §142 apart from Section 8. This separate data set for IRC §42 and §142 is called Multifamily Tax Subsidy Projects (MTSP) and includes both the Section 8 income limits and the HERA Special income limits. LIHTC and tax-exempt bond properties under IRC §42 and §142 still use Section 8 income limits,

but HUD now publishes the MTSP income limits to accommodate the HERA adjustments. The two adjustments from HERA are:

1. HERA Special adjustment for counties with no income decrease in 2007 or 2008 due to HUD's hold harmless policy
2. HERA hold harmless provision to prevent income limits from decreasing

Project-Based Approach

The HUD 2009 and 2010 briefing material for MTSP income limits, along with informal guidance from the IRS in LIHC Newsletter #35, indicate that only projects placed in service before January 1, 2009 qualify for HERA Special income limits.

This guidance also indicates that the income floor for the HERA hold harmless provision begins when the project is placed in service.

This project-based approach means that in 2010 there are two income limits for those counties that had a decrease in Section 8 income limits from 2009 to 2010. More than 500 counties had a decrease. For example, San Diego County, Calif. has two income limits in 2010 as follows:

1. 2009 MTSP for projects placed in service prior to May 14, 2010 that use the HERA hold harmless provision
2. 2010 MTSP for projects placed in service on or after May 14, 2010

This project-based approach also means that in 2010 there are three possible income limits for HERA Special counties.

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More than 1,000 counties qualify for the HERA Special limit. For example, Durham County, N.C. has three income limits in 2010 as follows:

1. HERA Special for projects placed in service prior to January 1, 2009
2. 2009 MTSP for projects placed in service on or after January 1, 2009 but prior to May 14, 2010 that use the HERA hold harmless provision
3. 2010 MTSP for projects placed in service on or after May 14, 2010

The project-based approach results in different income and rent limits in the same county depending on when projects place in service (See "Understanding the 2010 Income Limits" in the June 2010 Novogradac Journal of Tax Credits for more information).

Issues related to the project-based approach were not apparent until HUD removed its hold harmless provision on Section 8 income limits this year, and tax credit and tax-exempt bond projects had to rely on their own hold harmless rule from Section 3009(a) of HERA, which is now codified in IRC §42 and §142(d)(2)(E)(i). Now that HUD has removed the hold harmless provision for Section 8 income limits, there are counties that have income limits that decreased in 2010. Under the project-based approach, tax credit and tax-exempt bond projects placed in service after the income limits release date (May 14, 2010) must use those lower rent and income limits. Projects in service prior to May 14, 2010 can use the HERA hold harmless provision.

Hold Harmless Definition of "Determined"

The HERA hold harmless policy for tax credit and tax-exempt bond projects found in IRC §142(d)(2)(E)(i) reads as follows:

"Any determination of area median gross income under **subparagraph (B)** with respect to any project for any calendar year after 2008 shall not be less than the area median gross income **determined** under such subparagraph with respect to such project for the calendar year preceding the calendar year for which such determination is made." (emphasis added)

This doesn't specify that the project-based approach should be used, and can be interpreted as a county-based approach. IRC §142(d)(2)(E)(i) states that the income shall be **determined** under **subparagraph B**. IRC §142(d)(2) **subparagraph B** states that:

"area median gross income shall be **determined** by the Secretary in a manner consistent with **determinations of lower income families and area median gross income under section 8.**" (emphasis added)

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Novogradac Journal of Tax Credits Information

Address all correspondence and
editorial submissions to:
Alex Ruiz / 415.356.8088

Address inquiries regarding
advertising opportunities to:
Emil Bagalso / 415.356.8037

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ISSN 2152-646X

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HUD determines Section 8 income limits on a county basis and projects in a county use the same income and rent limits; HUD does not consider a project's placed-in-service date for selecting income limits. Determinations under subparagraph B, which are made in accordance with Section 8 rules, are always determined on a county basis, which means that IRC §142(d)(2)(B) income determinations should also be made on a county basis.

If the HERA hold harmless provision is applied on a project basis, the result is that projects in the same county have different income and rent limits depending on when they are placed in service.

If the HERA hold harmless provision is applied on a county basis, the result is that projects in the same county have the same income and rent limits no matter when they are placed in service.

Other Technical Issues

If the project-based approach continues to be used instead of a county-based approach, then the following issues require more guidance from the IRS:

1. Is the reference to calendar year in IRC §142(d)(2)(E)(i) based on a 12-month calendar year or a HUD income year?
2. When is the income limit determined for projects with buildings that are placed in service in different credit periods?
3. When is the income limit determined for projects with all or some buildings that defer the credit period?
4. When is the income limit determined for multi-building projects that elect no on Question 8b of IRS Form 8609 regarding the multiple-building election?
5. Should income and rent limits determined by the state for financial feasibility during application and carryover count as the income determination date instead of the placed-in-service date?
6. When is the income limit determined for acquisition rehabilitation projects that are not previously subject to a LIHTC regulatory agreement?
7. When is the income limit determined for acquisition rehabilitation projects that are subject to a previous LIHTC regulatory agreement?
8. Is there a corresponding income floor that is similar to the gross rent floor election discussed in IRS Revenue Procedure 94-57?

None of these technical issues would exist under the county-based approach.

Practical Issues

Under the project-based approach, in periods of decreasing Section 8 income limits, projects placed in service in later years will be at a financial disadvantage to projects that were placed in service in earlier years, in both the amount of rent they can charge and in the

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number of tenants that can qualify to live in the project. The project-based approach could also lead to the unintended consequence of making the HERA hold harmless provision ineffective because older projects might have to lower their rents to compete with newer projects placed in service in years with lower rent limits in the same neighborhood.

The project-based approach creates an administrative burden for state monitoring agencies, property managers and investors because of the complicated rules and multiple data sets. If property managers are unsure which income limit is correct they may move in tenants that do not qualify to live in their project, or may deny tenancy to tenants that do actually qualify to live in

their project; and rents might be over charged or under charged.

Two flow charts accompany this article. One is a project-based chart and one is a county-based chart. Note that these charts are for tax credit projects only. The tax-exempt bond charts would look similar except the national non-metro income and rent floor election do not apply.

The project-based chart demonstrates the administrative complexity associated with determining rents and incomes on a project by project basis. The only question that needs to be asked on the county-based chart is whether or not a project is in a rural area.

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This article first appeared in the July 2010 issue of the Novogradac Journal of Tax Credits.

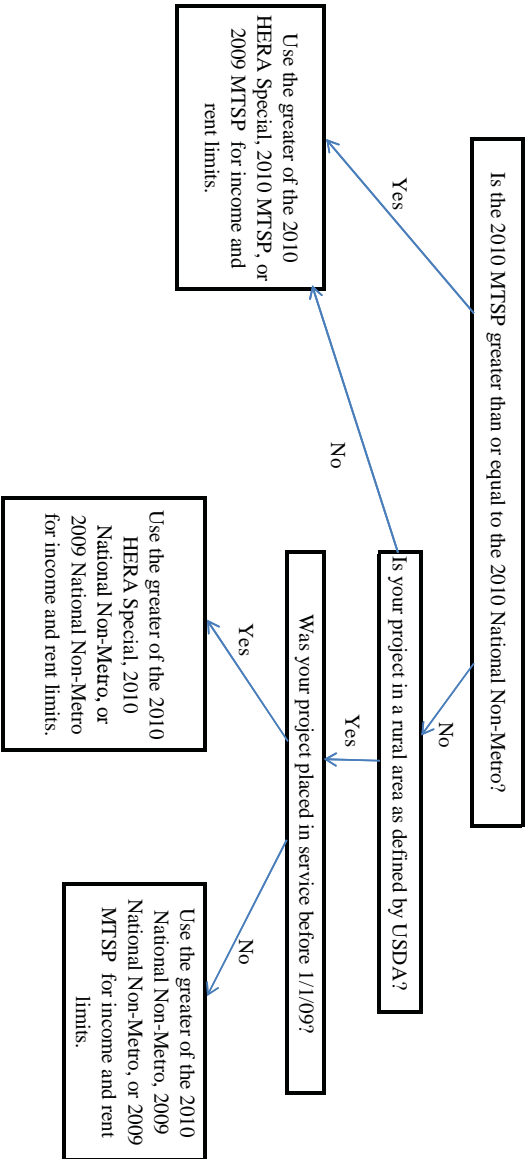
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Novogradac Rent and Income Calculator © Flowchart To Determine 2010 Limits for LIHTC Projects (County Based)



Assumptions:

1. Your project is in a rural area for 2010 if your project is in a rural area for 2009.
2. Your project is not in a rural area for 2010 if your project is not in a rural area for 2009.
3. The Rent and Income Limit Calculator© assumes that "calendar year" in the hold harmless rule means the HUD income limit year. For example, the 2009 calendar year means the HUD income limit year from 3/19/2009 through 5/13/2010.

This flow chart is for discussion purposes only. See 5/26/10 Novogradac Webinar for explanation. We strongly recommend that you check with the applicable state housing agency to verify that the flow chart agrees with the state agency's approach. Novogradac & Company LLP provides no assurance of the accuracy of the particular results you may obtain from the flow chart. The flow chart is designed only to be a quick reference tool and is no substitute for professional tax and accounting advice. The flow chart should not be used for any final financial decisions. Please contact a partner of Novogradac & Company LLP to calculate the rent & income limits for your specific projects. As consideration for your use of the flow chart without engaging us on a particular project, you agree to hold Novogradac & Company LLP harmless from any and all damages and claims related to use of this flow chart. If you do not agree with the terms of this paragraph, you may not use the flow chart.

