

LIHC MONTHLY REPORT

A MONTHLY PUBLICATION OFFERING NEWS, OPINION, FEATURES AND COMMENTARY ON THE LOW-INCOME HOUSING TAX CREDIT INDUSTRY

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IRS Rules Impact Fees May Be Included in Eligible Basis

By Alex Ruiz, Staff Writer, Novogradac & Company LLP

The Internal Revenue Service (IRS) last month released Revenue Ruling 2002-9, which says that state and local impact fees can be included in eligible basis for low-income housing tax credit projects. This ruling follows more than a year of debate and confusion started by a series of technical advice memoranda (TAMs) issued by the IRS in October 2000. (For a related article, see the Washington Wire on the back page.)

The TAMs, which also addressed issues such as land preparation costs and construction loan fees, were issued in response to questions about an audit of a low-income housing developer. They described what might be included in the basis of a property when calculating the amount of the credit that a state can allocate for a development, and have since had a serious impact on the affordable housing industry. The TAMs represented a position by the IRS that contradicted industry practice, and the resulting confusion left investors wary.

Michael J. Novogradac, managing partner at Novogradac & Company LLP in San Francisco, says, "The ruling is a great victory in the general area of impact fees, but there are other issues that we still need to resolve, including land preparation costs. Also, additional analysis is needed to determine how broadly to apply the new revenue ruling. The ruling provides a rather narrow definition of what constitutes impact fees. That definition will need to be applied on a facts and circumstances basis to real-life developers."

David Gasson, vice president of public and legislative affairs for Boston Capital Corp., agrees. "Impact fees are just one issue. They are very important, especially in states like California and Florida, and this ruling is going to be very helpful," Gasson says. "Now we have to focus our attention on the four remaining TAMs."

Accordingly, he says industry professionals are working with the Treasury Department as well as legislators. Specifically, affordable housing professionals have been campaigning in support of a measure introduced by Rep. Nancy Johnson (R-Conn.) late last year. House Resolution 3324 would amend the Internal Revenue Code to clarify the eligibility of certain expenses for the low-income housing credit. After being introduced November 16, 2001, the bill was referred to the House Ways and Means committee where it has remained. At press time, HR 3324 had nine co-sponsors.

Gasson expects progress on the remaining TAMs may be made as early as mid-year. He anticipates a resolution from the Treasury Department in June that would ad-

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LIHC WATCH

The U.S. Department of Housing and Urban Development (HUD) last month released fiscal year 2002 income limits. These figures, based on HUD estimates of median family income for 2002, are used to determine the income eligibility for applicants for the Public Housing, Section 8 and other programs. The new limits went into effect January 31. For more detailed information, visit www.taxcredithousing.com or refer to Novogradac & Company LLP's *Property Compli*

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dress many if not all unresolved issues. Because of the lengthy legislative process, Gasson says a regulatory review would be easier and more expeditious, but in order to resolve all the issues the most likely remedy will be a combination of Treasury Department and legislative guidance.

In the meantime, the current ruling will be subject to more detailed analysis to determine both its benefits and any possible weaknesses. Richard Goldstein, a partner at Nixon Peabody LLP in Washington, D.C., says he is very pleased with the relief the ruling will provide. "To put it in current events terms, the ruling was a 6.0. I think we even got the French judge," Goldstein says. "It vindicated a position that many people held: that the IRS was wrong in the position it expressed in the TAMs."

The specifics of the ruling are being scrutinized very closely. "A couple of caveats are in order, particularly with respect to developers utilizing the low-income housing tax credit (LIHC) program," Goldstein says.

He noted that developer wishing to satisfy the 10 percent carryover allocation test under Section 42 must include any impact fees in the calculation of reasonably anticipated basis. Thus, the target amount against which the 10 percent test must be measured would increase to the extent of any impact fees. "Of course, any impact fees that are incurred prior to the time required to meet the 10 percent test could be included in the taxpayer's carryover allocation basis," he says.

According to Goldstein, tax-exempt bond financing will also be affected by the ruling. "Developers who utilize private activity tax-exempt bond financing with LIHCs should be aware that any impact fees will similarly be included in the aggregate basis calculation against which the 50 percent test will be measured," he says.

"A developer hoping to obtain LIHCs by financing a project with such tax-exempt bonds must be sure that the bond proceeds utilized to finance land and buildings is more than 50 percent of the aggregate basis of the project's land and buildings. Impact fees will be includable in the basis of the building(s) and thus, the 50 percent test must be met by taking those fees into account. Developers of projects who have been moving forward assuming that impact fees were not includable should review their numbers to make sure that the 50 percent test can be satisfied under this new ruling."

Beyond these issues, Goldstein says the ruling's effects will differ from project to project. "This will take a little bit of sorting out between the partners who have been caught in this position," he says. "There is a range of ways that deals were structured, so now it's time to go back, factor in this decision, and make adjustments accordingly."

The full text of the ruling and each of the TAMs is available at www.taxcredithousing.com. To learn the latest TAMs news as it happens, subscribe to Novogradac & Company LLP's Industry Alerts e-mail service. Simply e-mail cpas@novoco.com with "subscribe" in the subject line. ♦

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