

PROPERTY COMPLIANCE REPORT

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IRS Makes Important Changes to Form 8823 Guide

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The Internal Revenue Service (IRS), in collaboration with the National Council of State Housing Agencies (NCSHA), last month released the much anticipated "Guide for Completing Form 8823 Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition." The 8823 Guide serves to clarify some of the gray areas of low-income housing tax credit (LIHTC) compliance and gives guidance to the state agencies for preparing Form 8823. The 8823 Guide cannot be cited as authority by taxpayers for setting or sustaining a technical position and taxpayers are responsible for evaluating the tax consequences of noncompliance with Internal Revenue Code (IRC) §42; however, the 8823 Guide does give important insight into what issues state agencies might consider as noncompliance to be reported on Form 8823. A summary of some of the important changes in the 8823 Guide since the draft was released a few years ago begins on page 2. A full analysis of the 8823 Guide will be provided in the March issue of the *Property Compliance Report*.

Incomplete or Imperfect Documentation

State housing agencies may allow owners to reconstruct records when the situation dictates, consider incomplete or imperfect documentation and accept credible oral testimony to determine the overall compliance in requirements of IRC §42. For example, a couple's current income recertification was signed in a timely manner by the wife, but the husband's signature is missing because he is on active military duty and stationed out of the country. The husband's income is included in the recertification and the reporting instructions for his overseas assignment are included in the file. The state agency may consider the unit in compliance, even though the husband's signature is missing. (Page 3-6)

Family Size Increase

The addition of new member(s) to an existing low-income household requires the income certification for the new member of the household, including third-party verification. The new tenant's income is added to the income on the existing household's tenant income certification. The household continues to be income-qualified, and the income of the new member is taken into consideration with the income of the existing household for purposes of the available unit rule under IRC §42(g)(2)(D). (Page 4-3)

This change is a mix of good and bad news. The bad news is it creates more work for the property manager by requiring that interim recertifications be performed when adding household members in a unit. However, the good news is that the unanticipated addition of a new household member during the first year will not put a tenant over the income limit. However, if the IRS determines that the tenants manipulated the income certification process, then the unit should not be considered to be low-income. For example, an income-qualified household consisting of one person moved into a two-bedroom unit on March 15, 2005. A second tenant completed an initial income certification and joined the household soon thereafter. The combined income of the two tenants is above in income limit for a household with two members. The unit is out of compliance as of March 15, 2005. (Page 4-4)

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120 Day Verification Window

Throughout the 8823 Guide the IRS refers to a 120 days as the timeline for providing third-party verification. According to the 8823 Guide, the preferred verification method is through third parties, and such verifications must be no older than 120 days before the effective date of the tenant income certification. (Page 4-21). The 8823 Guide appears to be increasing the limit for verification to 120 days from 90 days as outlined in the U.S. Department of Housing and Urban Development (HUD) Handbook 4350.3.

Transfers Between Buildings

The 8823 Guide cleared up some of the grey areas that surrounded tenant transfers. The 8823 Guide has made it clear that when a tenant, whose income is less than 140 percent of the income limit, transfers to a new unit, the vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident (units swap status). This is true whether the tenant is transferring within the same building or to a new building within the same project. (Page 4-16) A new certification is not required when a household moves to another unit in a different building. The household's current income (re)certification, as well as the lease, moves with them. When tenants move within the project, the (re)certification paperwork moves with the tenant to the new unit's file folder (Page 4-19). The income status is determined from the most recent (re)certification. If the tenant's most recent (re)certification is more than 12 months prior to the transfer, then a recertification would have to be completed as soon as possible and there is potentially noncompliance for the time period from the due date of the recertification to the date the recertification is completed. This is good news for tenants whose incomes are less than 140 percent of the income limit and who want to transfer between buildings in a project. However, the IRS is excluding tenants who earn more than 140 percent of the income from transferring between buildings within the same project. Note that some state agencies may still require a certification for all transfers between buildings.

Acquisition/Rehab Safe Harbor

For purposes of Rev. Proc. 2003-82, the incomes of the individuals that occupied a unit before the beginning of the first credit year must be tested for purposes of the next available unit rule within 120 days prior to the beginning of the first year of the credit period. For example, an owner purchased an existing building on March 1, 2004 and anticipated beginning the credit period on January 1, 2005. Household A, an income-qualified household, moved into a rent-restricted unit on April 1, 2004. Because the household was determined to be income-qualified more than 120 days before the beginning of the credit period, the household's income must be tested within the 120 days before January 1, 2005 to determine whether the next available unit rule should be applied. Household B, an income-qualified household, moved into a rent-restricted unit on October 1, 2004.

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Because the household was determined to be income-qualified within 120 days before the beginning of the credit period, the household's income does not have to be tested again before January 1, 2005. Note that properties that are 100 percent low-income may find some relief in the testing because they generally satisfy the next available unit rule (Page 4-18).

Correcting Errors

The IRS has consistently stated that errors corrected before the state reviews the file should not be reported to the IRS. For example, if a property manager forgot to sign the income certification and then later signs the form before the state agency inspects the files, then no Form 8823 should be filed. However, in some cases there is not enough information to simply correct the errors and more information will need to be obtained. The 8823 Guide adds clarification on how to correct issues where there is insufficient documentation in the file. The two ways are:

New Certification:

A new certification can be performed using current income and asset sources and current income limits. Assuming the household is eligible, the unit would be out of compliance on the date of move-in and back in compliance on the date the new certification is signed; Form 8823 should be filed.

Retroactive Recertifications:

A retroactive certification can be performed that completely and clearly documents the sources of income and assets that were in place at the time the certification should have been effective, and applies income limits that were in effect on that date. The tenant should date the document with the current date of signature with a statement that says the information is true and correct as of the effective date of the certification. Assuming the owner can document that the household was income eligible at the time of move in, the unit should not be considered out of compliance. The owner has clarified the noncompliance; Form 8823 should not be filed. (Page 4-25)

Managers Unit and Free Rent

The 8823 Guide indicates that charging rent for a manager's unit may take away the exempt status of the unit. If the owner is charging rent for the unit, the IRS may determine that the unit is not reasonably required by the project because the owner is not requiring the manager to occupy the unit as a condition of employment. (Page 8-3)

Overcharging Tenants

Overcharging tenants for rent in the first year of the compliance period can disqualify the owner from claiming any credits. The 8823 Guide indicates that an owner cannot avoid the disallowance of the LIHTC by rebating excess rent to the affected tenants in any year of the compliance period. (Page 11-6 and 11-7)

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Newly Married Students

Further clarification was provided concerning married full-time students. A married couple that is entitled to file a joint tax return but has not filed one, still satisfies the exception to the full-time student rule. For example, a recently married full-time student couple is looking for housing. The couple is income-qualified, but they have not yet filed their first tax return. Even if the couple does not file a joint tax return, they are still entitled to file a joint return and thus satisfy the exception. (Page 17-2) Also note that K-12 is considered full-time student status. (Page 17-1)

State Issues

The 8823 Guide in numerous places makes it clear that state noncompliance issues should not be reported on Form 8823. This includes reporting state specific violations of the extended-use agreement and deeper rent restriction imposed by the state. For example the owner elected the 40/60 minimum set-aside on Form 8609 and the owner charges rent of \$500. The state agency required 20/50 targeting, as evidenced in the extended-use agreement. The maximum 50 percent gross rent is \$400, but the maximum 60 percent gross rent is \$500. The rent charged is above the limit agreed upon in the extended-use agreement, but equals the rent limit for the 60 percent minimum set-aside election. The owner has violated the state's requirements. However, the rent is in compliance within federal regulation. The state agency should not file a Form 8823. (Page 23-1)

Conclusion

The 8823 Guide is a good tool for determining what state agencies will be looking for when they review properties for compliance, however, it is important to note that some states have more restrictive requirements. Please contact your state agency before relying on the 8823 Guide. The guide can be found online at www.taxcredithousing.com. ❖

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