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California Tax Credit Agency Releases 'Good Cause' Documents

By Alex Ruiz, Staff Writer, Novogradac & Company LLP

In response to a provision in Internal Revenue Service (IRS) Revenue Ruling 2004-82 that clarified its position on the requirements for extended use agreements for low-income housing tax credit (LIHTC), the California Tax Credit Allocation Committee (TCAC) last month published a set of documents for owners and managers of LIHTC properties. TCAC's clarification addresses Question and Answer #5 in Revenue Ruling 2004-82 that contradicts the universally understood requirements that have long been used by state housing finance agencies and LIHTC professionals. The provision left some industry professionals concerned about its potential effects on state housing finance agency officials, LIHTC partnerships, lenders and other parties to existing extended use agreements, as well as, according to some, the possibility of total credit recapture for LIHTC investors.

Background

Internal Revenue Code (IRC) §42(h)(6)(D) defines the extended use period as a 30-year period, or a longer period if required by the state agency. IRC §42(h)(6)(E)(i) allows an early termination to the extended use period if there is a foreclosure or if there is no qualified contract to buy out the investor after the 15-year compliance period. IRC §42(h)(6)(E)(ii) describes a three-year period following such termination as a time during which two things are expressly prohibited; (1) the eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit and (2) any increase in the gross rent with respect to a low-income unit not otherwise permitted under §42. Until recently, LIHTC professionals thought these prohibitions were applicable only to the three-year period it described.

IRS Revenue Ruling 2004-82, issued July 29, 2004, addressed 12 points under §42; 10 of the 12 points were compliance related and answered several long-standing questions. However, one point — the IRS position on the requirements of extended use agreements — raised red flags for state housing agency officials and LIHTC investors. In Rev. Rul. 2004-82, the IRS says an extended low-income housing commitment must prohibit evictions (other than for good cause) and prohibit increases in gross rent described in IRC §42(h)(6)(E)(ii)(I) and (II) throughout the 15-year compliance period and the entire extended use period — not just for the three-year period described in IRC §42(h)(6)(E)(ii) — as had been commonly accepted by LIHTC professionals. Upon the ruling's release, the National Council of State Housing Agencies (NSCHA), and others, said the IRS's position "raised concerns."

Good Cause

On April 8, 2005, TCAC issued new rules implementing a "good cause" standard for all affordable housing tenant evictions and renewals. The Washington State Housing Finance Commission (WSHFC) enacted a similar "good cause" policy late last year. (Details about the WSHFC policy were published in the December 2004 issue of the *Property Compliance Report*.)

Some LIHTC industry participants have expressed concern that the new TCAC standard may create new problems for LIHTC property owners and managers because it is ambiguous. Under the new TCAC policy, a rider will need to be added to all leases that reads:

"Owner may not terminate the tenancy or refuse to renew the lease or rental agreement of a low income tenant except for good cause, including a serious or repeated violation of the material terms and conditions of the lease, or a violation of applicable federal, state, or local law. To terminate the tenancy or refuse to renew the lease, owner must provide written notice to the tenant of the grounds with sufficient specificity to enable the tenant to prepare a defense. The notice must be served at least three

(continued on page two)

California Tax Credit Agency

(continued from page one)

days before the termination of tenancy, and must comply with all requirements of California law and other applicable programs. Tenant has the right to enforce this requirement in state court, including presenting a defense to any eviction action brought by owner."

"While there is a substantial question whether Rev. Rul. 2004-82 is simply wrong as a matter of law, there is a further, more immediate question whether TCAC's proposed rider is appropriate and workable," says Steve Ryan, an attorney with Cox, Castle & Nicholson LLP. "The IRS has not defined what 'good cause' means or how it should be enforced, and the various states have been groping to come up with a workable solution."

"This may not change things drastically because many owners already evict only for 'good cause'," says Jim Kroger, CPA, a partner in Novogradac & Company LLP's San Francisco office. "This new 'good cause' language doesn't really change the rules, but it may give tenants the perception that they can get away with breaking house rules. This may also increase the level of tenants seeking legal action if they are evicted, even if it is for what typically has been considered 'good cause' in the past such as drug dealing, disturbance, destruction, or housekeeping habits.

"If the level of legal action increases, then owners of LIHTC properties that already have marginal financials resources, will be faced with spending additional resources proving that their evictions were for 'good cause.' The IRS did not define 'good cause' or require that the state agencies define it. That may be just as well since no definiton will cover all of the facts and circumstances that would fall within what a reasonable person would consider 'good cause' for evicting a tenant." ❖

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Address all correspondence and editorial submissions to:
Jane Bowar Zastrow
Property Compliance Report
Novogradac & Company LLP
246 First Street, 5th Floor
San Francisco, CA 94105
Telephone: 415.356.8034
E-mail: cpas@novoco.com
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