

PROPERTY COMPLIANCE REPORT

A MONTHLY PUBLICATION ON LOW-INCOME HOUSING TAX CREDIT COMPLIANCE

November 2000, Volume III, Issue XI, Published By Novogradac & Company LLP

Failing the Minimum Set-Aside Test in the First Year Will Disqualify Project

By James R. Kroger, CPA

Question: Does failing the minimum set-aside in the first year of the tax credit period disqualify a project from receiving tax credits?

Answer: Yes. Failing to meet the minimum set-aside test by the close of the first year of the tax credit period will disqualify a project from receiving tax credits, according to Internal Revenue Code Section (IRC) Section 42(g)(3). The first year of the tax credit period is the taxable year in which the project is placed in service, or at the election of the taxpayer, the succeeding taxable year. Although deferring the tax credits may severely affect the internal rate of return of the investor, it is definitely the prudent decision if the investor is faced with the alternative of losing all tax credits or taking the tax credits one year later.

Assume that an owner has elected the 20/50 minimum set-aside under IRC 42(g)(1). The election reads, "The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income (AMGI)."

If the owner has targeted no more than 20 percent of units to low-income tenants, there is no room for error. For example a 100-unit project with 20 units targeted to low-income tenants may be disqualified from using its entire credit reservation if just one of the low-income targeted tenants is out of compliance. We recommend that, in this case, the owner target additional units above the set-aside to provide some room for error in the tenant files.

Additionally, we strongly recommend a review of the tenant files, by our firm or an independent party, prior to the close of the first tax credit period to catch errors that need to be corrected prior to the close of the first tax credit period.

If you have a question, contact the *Property Compliance Report* at (415) 356-8088. ♦

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