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Don't Panic: What to Do if You Get a Form 8823 of Noncompliance

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N“Nothing travels faster than the speed of light, with the possible exception of bad news, which obeys its own special laws.”—Douglas Adams

In the 18 years I've worked in the low-income housing tax credit (LIHTC) world, I've had clients ask about 8823s and the consequences of receiving them, but, usually, by the time the questions are asked, the panic has set in.

Form 8823s are bit of a taboo subject; as if merely speaking this sequence of numbers will magically make the document appear and cost millions of dollars. The fact is that in today's compliance world, corrected 8823s rather than uncorrected 8823s are the norm rather than the exception, especially for physical issues and most state agencies are quite understanding. They know mistakes happen and they want us to do what we've set out to do, which is to provide affordable housing for qualified households. Based on that understanding, for the most part, they don't want to send out 8823s, or they want to classify the noncompliance on the 8823 as “corrected” rather than “uncorrected.” With this in mind, I would like to step into this taboo subject and talk about what an 8823 communicates to the IRS, the difference

between a corrected and an uncorrected 8823, the consequences of receiving an 8823, and finally, what can be done when it's sent as uncorrected to the IRS. Let's be fearless together.

What Does an 8823 Communicate?

The 8823 Form is used when LIHTC noncompliance is identified by a state agency in order to notify the IRS of that noncompliance. In 2011, the IRS gave guidance in the form of the 8823 Guide to provide direction to state agencies in identifying and reporting noncompliance as well as identifying and reporting the status of returning to compliance. While the Guide is not an engrossing read and won't place on The New York Times best-seller list anytime soon, it is exceptionally useful and a “must read” for any compliance professional.

What is the Difference Between a Corrected and an Uncorrected 8823?

If the noncompliance reported in 8823 was corrected within the state's correction period, normally 30 or more days after the date of the state's findings letter,

continued on page 2

continued from page 2

or corrected even on the day of the audit, state agencies are still required to report federal findings on Form 8823 to the IRS.

A corrected 8823 should evidence diligence in ensuring that noncompliance was corrected quickly and appropriately.

A corrected 8823 tells the IRS that the state agency found reportable noncompliance, a reasonable period to correct it was given and that the owner/agent complied with the requirements and is now back in compliance.

An uncorrected 8823 is a bit more complex and is cause for concern. Any diligent owner/agent will always work to ensure that an uncorrected 8823 is fixed as soon as possible and will remain in contact with their state agency to provide updates on the status of corrections.

An important thing to keep in mind regarding correcting noncompliance are dates buildings go out of compliance and dates they are returned to compliance as reflected on lines 8 and 9 of the Form 8823. The date a building ceased to comply is the earliest date of noncompliance, so, if you have two units that are out of compliance, one that went out Feb. 1, 2018, and the other July 1, 2018, the date on line 9 of the 8823 will be Feb. 1, 2018.

When the noncompliance is corrected, the next box will show the final correction date. If, once again, you have more than one unit out of compliance, there will not be a date listed until all units are back in compliance. Finally, line 10 is checked if an uncorrected 8823 was previously sent to the IRS and the state is now notifying the agency of the project returning into compliance.

What are the Consequences?

An understanding of how to read Form 8823, specifically lines 11a through 11q, is essential to understanding

consequences. This is where noncompliance issues are checked out of compliance as well as back in compliance.

Without going through all of the possible findings listed on the 8823, it's safe to say that some are worse than others, such as 11g, "Gross rent(s) exceed tax credit limits" and 11l "Low-income units occupied by nonqualified full-time students."

Make a simple mistake in miscalculating a utility allowance, even by a dollar, such that the tenant is paying more rent than they should, and the unit is out of compliance for the remainder of the year, even if you credit the rent back to the tenant. The end of noncompliance date will be Jan. 1 of the next year no matter what.

It's essentially the same with a full-time student household finding. The IRS considers a household a full-time student household if everyone, including children, are going to school full time for five months out of the calendar year (and meets no exception). As an example, an 18-year-old, just out of high school, moved into a newly leased property. She didn't understand that the student question included high school and staff took her answers at face value without considering her age. The owner could not claim credits for that unit that year since she was a full-time student, in high school, for five months in the calendar year. An understandable, yet costly mistake.

Worse than that, if you've overcharged rent on all the units because of a utility allowance mistake or if you've been housing unqualified full-time student households, you are not meeting the minimum set aside test requirement and the entire property could be kicked out of the LIHTC program and, of course, line 11f, will be checked on the 8823 form. 11f has a "back in compliance" box that can be checked, which means even this, possibly the worst finding, still has the hope of correction.

continued on page 3

continued from page 2

Most findings, such as over-income households or an incomplete certification, can usually be corrected, at the very least, with a new household file. Remember that the “new” file can sometimes be for the same tenant who put the unit out of compliance in the first place. Because of the time and expense, it might make more sense to keep a tenant that qualifies now as opposed to an eviction and qualifying a new household to occupy the unit.

The most common 8823s are for violations of Uniform Physical Condition Standards (UPCS). Someone sometime is going to take out the battery of a smoke detector or move a piece of furniture in front of the window or have their gas utility turned off because “they aren’t using it anyway”—which is, strangely, the owner’s fault. Sure, you can inspect on a quarterly basis and right before the state’s visit and fix everything you find but someone will do something to mess it up.

What Can Be Done about Uncorrected 8823s?

Now for some better news. Even when an 8823 is sent to the IRS as uncorrected, there is still a chance to correct the issue and have a corrected 8823 sent to the IRS. There is a time limit, so we must act quickly. For the most part, you can avoid an uncorrected 8823 as long as you:

1. Correct noncompliance as you come upon it. Remember, if noncompliance is self-discovered and corrected before the state’s notice of an audit, those issues are not reportable to the IRS.
2. When responding to noncompliance, get it right the first time. If it’s not corrected the first time and tenants move or the state is delayed in reviewing the response this could lead to bigger issues and more noncompliance.

3. Don’t be afraid to question findings when warranted. For the LIHTC program to be effective, it has to be able to stand up to a little bit of scrutiny now and then and most state agencies are open to conversation about their findings.

So, when is the time to panic? Well, never, it’s very unproductive.

Keep in mind that state agencies don’t want any property to lose its LIHTC status over unintentional, human errors, so they will usually work with owners as much as they are able. This is why it’s important to build relationships with state agency staff and to stay in regular, positive communication. The correction period state agencies give us can vary depending on the state. Also, in special circumstances, states have latitude to grant even more time for corrections; potentially up to six months. These circumstances usually involve the tenant being severely, and possibly unjustly, impacted and so states are more inclined to give more time when that is the case.

Do your best to be aware, be involved and be a helpful partner in this task. And, if you’ve tried your best to avoid an 8823 but still receive one, focus on achieving resolution as quickly as possible with as little collateral damage (to owners, managing agents, associates and residents) as possible.

“And so the universe ended,” Douglas Adams.

“(But not because of an 8823),” Anonymous. ❖

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continued on page 4

continued from page 3

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