Chapter 21
Category 11p
Project is No Longer in Compliance Nor Participating in the Program

Definition

This category should be used to notify the Internal Revenue Service that a building is entirely out of compliance and is no longer participating in the program.

1. The determination that an LIHC building is entirely out of compliance and will not be in compliance at any time in the future is a recapture event under IRC §42(j).

2. The filing of a Form 8823 for this category also puts the IRS on notice that the state agency is no longer performing monitoring activities with respect to the property.[1]

3. The building is no longer considered a qualified low-income building under IRC §42(c)(2)(A).[2] No credit is allowable in the remaining years of the credit period, even if the building complies with all the requirements of IRC §42.

Out of Compliance

A state agency may find that a building is no longer in compliance with the LIHC program requirements, and thus, is no longer participating in the program. The following discussion provides a broad overview of issues that may justify terminating an owner's participation in the program. It is not an exhaustive list; state agencies should consider each case individually based on the specific facts and circumstances.

Return of Credits to State Agency

Under certain circumstances, a state agency may obtain return of previously allocated low-income housing credits. In accordance with Treas. Reg. §1.42-14(d)(2)(ii), these credits may be returned up to 180 days following the close of the first tax year of the credit period for the building that received the allocation. If a credit is returned within 180 days following the close of the first taxable year of a building's credit period as provided in Treas. Reg. §1.42-14(d)(2)(ii), and a Form 8609, Low-Income Housing Credit Allocation and Certification, has been issued for the building, the state agency must notify the Internal Revenue Service that the credit has been returned.

If only part of the credit has been returned, this notification requirement is satisfied when the state agency attaches to an amended Form 8610, Annual Low-Income Housing Credit Agencies Report, the original of an amended Form 8609 reflecting

[1] Treas. Reg. §1.42-5(e)(3).
[2] IRC §42(c)(2) states that the term "qualified low-income building" means any building which is part of a qualified low-income housing project at all times during the period beginning on the 1st day in the compliance period on which such building part of such a project, and ending on the last day of the compliance period with respect to such building.

the correct amount of credit attributed to the building together with an explanation for filing of the amended forms. The state agency must send a copy of the amended Form 8609 to the owner of the building.

If the building is not issued an amended Form 8609 because all of the credit allocated to the building is returned, notification to the Internal Revenue Service is satisfied by following the requirements prescribed by Treas. Reg. §1.42-5(e)(3) for filing Form 8823.

Treas. Reg. §1.42-14(d)(2)(iv) specifies the reasons for the return of the entire amount of allocated credit:

1. The building is not placed in service within the required time period or fails to meet the minimum set-aside requirements of IRC §42(g)(1) by the close of the first year of the credit period.

2. The building does not comply with the terms of its credit allocation. The terms of an allocation are the written conditions agreed to by the state agency and the allocation recipient in the allocation document.

3. The owner and state agency mutually agree to cancel an allocation of credit by mutual consent.

4. The state agency determines, under IRC §42(m)(2), that an amount of credit allocated to a project is not necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period.

IRS Notification

An attachment should be used to explain that the credits are being returned under the authority of Treas. Reg. §1.42-14(d)(2)(ii) and why the property did not qualify.

Owner Notification

As provided in Treas. Reg. §1.42-14(d)(3)(i), after a state agency determines that building or project is not in compliance for the reasons 1, 2 or 4 above, the state agency must provide written notification to the allocation recipient, or its successor in interest, that all or part of the allocation is no longer valid. The notification must also state the amount of the allocation that is no longer valid. The date of the notification is the date the credit is returned by the state agency.

If an allocation is cancelled by mutual consent as noted in number 3 above, there must be a written agreement signed by the state agency and the allocation recipient, or its successor in interest, indicating the amount of the allocation that is returned to the state agency. The effective date of the agreement is the date the credit is returned to the state agency.

Egregious Noncompliance with Program Requirements

Egregious noncompliance is conspicuous, flagrant, and systemic in nature and includes the failure to make reasonable attempts to comply with the requirements of the program, or careless, reckless, or intentional disregard of program requirements.

Example 1: Failure to Make Reasonable Attempts to Comply with Program Requirements

The owner did not allow the state agency to conduct physical inspections or tenant file reviews after the end of the 10-year credit period.

Explanations from the owner should be solicited and analyzed for reasonableness. It is important that the owner be given an opportunity to respond and provide explanations. The reasonableness of the explanations should be evaluated for credibility, presence of corroborative or contradictory evidence, and collateral evidence from third party sources. Refer to Chapter 3 for additional guidance.

An attachment to Form 8823 should be used to explain the extent of noncompliance.

The Owner has Voluntarily and Permanently Withdrawn From the Program and is No Longer Claiming Credits

An owner, during the 15-year compliance period, may voluntarily withdraw a project from the low-income housing credit program, but retain ownership. The building still exists physically, but is not being operated as an LIHC project. For example, the owner may have converted the entire building to a use other than as an LIHC housing project or 100% of the units may be vacant (and the owner has no intention of renting any of the units in the future).

An attachment to the Form 8823 should be used to explain why the project was withdrawn and identify the last year the property was in service. This information is needed for the IRS to determine whether the owner properly recaptured accelerated credits.

Failure to Respond to Repeated Requests for Reports, Certifications, Reviews, or Other Essential Communication

State agencies may remove an LIHC property from the program if the owner fails to respond to *repeated* notices for monitoring reviews[3], or annual reports and owner certifications are not submitted, *and* Forms 8823 identifying the noncompliance were previously submitted to the IRS.

1. Under the inspection provisions of Treas. Reg. §1.42-5(d)(1), the state agency must have the right to perform an on-site inspection of any low-income housing project at least through the end of the compliance period of the buildings in the project.

2. Under the certification provisions of Treas. Reg. §1.42-5(c), state agencies may remove a property from the program if annual reports and owner certifications are not submitted

A state agency should send follow-up notices clearly stating that failure to respond will result in the agency notifying the IRS that the property is no longer in compliance and is no longer participating in the LIHC program. See Treas. Reg. §1.42-5(e)(2), which requires the state agency to provide prompt notification to the owner if the project is not in compliance with the provisions of IRC §42.

The date of noncompliance is the first day of *the first year* that the owner failed to provide annual reports or certifications or did not respond to a request for the

[3] See Treas. Reg. §1.42-5(c)(2).

physical inspection of the property.

Building No Longer Participating in the Low-Income Housing Program

When a building is no longer in compliance nor participating in the Low-Income Housing Credit Program, state agencies need to address two issues, as discussed below.

Extended Low-Income Housing Commitment

IRC §42(h)(6)(D) requires a property owner to commit to the low-income housing program for a minimum of 30 years. The commitment is documented as a restrictive covenant against the property and is recorded against the property as a deed restriction governed by state law. Commonly know as "extended use agreements", these covenants are agreements *between the owner and state agency.* Consideration should be given to enforcing the agreement through a civil court proceeding. However, when a building or project is removed from the program, state agencies have discretionary authority to release the extended use agreement and remove the deed restriction.

Protection of Tenants Rights

Under IRC §42(h)(6)(E)(ii), there are two requirements that must be met when an extended use agreement is terminated:

1. No eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit before the close of the 3-year period following the termination of the extended use agreement, and

2. No increase in the gross rent of any unit occupied by an existing tenant before the close of the 3-year period following the termination of the extended use agreement, not otherwise permitted under IRC §42. In other words, units occupied by income-qualified tenants continue to be rent restricted for three years, or until the tenants vacate the units.