

Low Income Housing Credit Newsletter

Internal Revenue Service

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The purpose of this newsletter is to provide a forum for networking and sharing information among LIHC program coordinators and examiners. It is a means by which to communicate technical information, issues developed through examination activity, industry trends and any other pertinent information which surfaces from time to time. Articles and ideas for future articles are most welcome!!

Participation of Nonprofits

Projects receiving credits from state housing authorities which have been allocated under the 10% set aside (IRC §42(h)(5)) must meet specific requirements to be eligible to claim the credit.

The first requirement is the involvement of an organization which qualifies as a nonprofit under §501(c)(3) or §501(c)(4) of the code. This entity cannot be affiliated with, or controlled by, a for-profit organization. It must also have an ownership interest in the project and be a material participant in the development of the project and its operation throughout the 15-year compliance period.

Material participation is defined in IRC §469(h) and Treasury Regulation 1.469-5T. The Office of Chief Counsel has confirmed that the definition of material participation generally applied to individuals can be applied to nonprofit organization. By inference, the applicability of the seven tests found in the regulations can be applied to nonprofits as well.

References:

- Memorandum for Regional Chief Compliance Officers from Raymond J. Smith, dated 3/14/2000.
- *Housing Pioneers, Inc. v. Commissioner*, 49 F.3d 1395 (9th Cir. 1995).

How a MOU can Benefit the State Housing Authorities

The Georgia Department of Community Affairs (administrator of the LIHC program for the state) required developers to submit Forms 8821, Tax Information Authorization, for all of their existing projects when applying for Georgia credits in 2000.

When properly completed, Form 8821, in conjunction with a MOU, allows the Internal Revenue Service to notify the state of any compliance problems reported on Forms 8823 in other states, as well as audit results for LIHC issues related to the specified project.

There are certain pitfalls in this process to be avoided. First, specifying only Form 1065 in Box 3 (b) of the 8821 is insufficient. It must include Form 8823 (and anything else the state might want researched) that is not part of the 1065. The second potential pitfall concerns the taxpayer's signature. It is important to ascertain that the person signing the 8821 is authorized to do so.

If you wish to assist your state during their next round of applications, it is suggested that you discuss it with your contact at the Philadelphia Service Center in advance so that you don't encounter delays in implementing the practice.

Revenue Procedure 99-11: Alternative to Posting Bonds

Under Section 42(j), if a taxpayer disposes of a low income housing property during the 15-year compliance period, then the accelerated portions of the credit must be recaptured. Taxpayers can avoid credit recapture if the property is maintained as low income housing property by the new owner and the taxpayer posts bonds equivalent to the amount of credits that would otherwise be recaptured.

Revenue Procedure 99-11 provides an alternative to the requirement that a surety bond be posted. The taxpayer now has the option of pledging certain U.S. Treasury securities in lieu of the surety bond. The Rev. Proc. was created in response to the difficulty taxpayers were having in locating surety companies that offer surety bonds for LIHC buildings.

Revenue rulings (e.g. Rev. Rul. 99-24) are periodically published which give the taxpayer a bond factor amount to be used to arrive at the amount of the security which must be posted. The actual process is handled through the Bureau of Public Debt.

If you have any questions, or a taxpayer needs help, please call Angie Kaminski at the Philadelphia Service Center.

Federal Grants Reduce Eligible Basis

By Patty Bornheim, Revenue Agent

The routine review of the state application package revealed that a federal grant from the HOME program was included in the financing of the project. Since the eligible basis for the project had not been reduced by this grant, copies of the HOME grant and the partnership agreement were requested and inspected. The HOME grant was made to the general partner, a tax-exempt organization, who, in turn, loaned the funds to the LIHTC partnership.

The partnership agreement read, in part, that cash flow distributions were to occur on a regular basis and that repayment of the HOME loan would only take place after payment of other expenses, including other debt instruments.

An adjustment was proposed to reduce the basis of the project by the amount of the Federal HOME grant based on IRC §42(d)(5)(A), which states: “If, during any taxable year of the compliance period, a grant is made with respect to any building or the operation thereof and any portion of such grant is funded with Federal funds (whether or not includible in gross income), the eligible basis of such building for such taxable year and all succeeding taxable years shall be reduced by the portion of such grant which is so funded.”

Also applicable is Revenue Ruling 96-35, I.R.B. 1996-31, 4, (Aug. 04, 1996) which cites Section 42(d)(5). It “provides that if, during any taxable year of the compliance period, a federal grant is used for a building or its operation, the eligible basis of the building for the taxable year and all succeeding taxable years is reduced to the extent of the federal grant.”

The rationale for the adjustment is that since the “loan” of HOME grant monies is subordinate to other partnership debt, it is an indirect Federal grant. The taxpayer agreed to an adjustment to the eligible basis of the property.

Qualified Tenants & Records: Reviewing Internal Controls

In an article in the “Property Compliance Report”, Jim Kohn states that a comprehensive software program forces a property manager to keep consistent and legible records. The author states that most tenant file problems stem from handwritten documents and manually maintained records and reports.

He cites as examples of errors he has encountered: certifications that had written-over birth dates and social security numbers, illegible names for family members, and rent rolls and certifications that did not agree as to occupancy. Mr. Kohn also points out that the use of a well-designed software program will result in completeness, consistency, legibility and timeliness in project records.

It should also be noted that the state housing agencies have the authority to require standardized documentation by projects. IRC §42(m) addresses the responsibility of housing credit agencies to administer the program and monitor taxpayer compliance. The Regulations outline the procedures a state agency must follow in monitoring for noncompliance and specifically provide that the monitoring procedures may contain additional provisions or requirements.

From an IRS auditing perspective, the requirement to evaluate a taxpayer’s internal controls is found in IRM 4.2, Handbook for the Examination of Returns. The presence of a properly used software system and computerized records can minimize the amount of testing required. However, one must not assume that the taxpayer’s stated internal controls are actually in place and effective unless they are tested. Good internal controls do not eliminate the need for certain basic steps, i.e. knowledge of the organizational structure and business operations, an understanding of its accounting system, and a tour of the project.

When cases of poor record keeping are encountered, issuance of an Inadequate Records Notice to get the taxpayer back into compliance may better reflect congressional intent than disallowing the credit. See IRM 4.2.8.15 for additional guidance. Factors to consider include:

- An alternative method was used to establish the amount of eligible basis, gross income, etc.
- Prior history and present degree of noncompliance
- Indications of willfulness or evidence of refusal to keep adequate records
- Inadequate records will result in significant underreporting of tax liabilities

Keep in mind that group manager involvement is required when considering issuance of a notice.

Reference:

- Jim Kohn, "The Pen vs. the Computer: Managing Low-Income Housing Properties with Assurance", Property Compliance Report, Novogradac & Company, LLP, Volume III, Issue IV.
- IRM 4.2.3
- Memorandum from National Director, Compliance Specialization to Regional Chief Compliance Officers dated 8/25/1999.

ERCS Tracking Code

The correct ERCS tracking code is 9812, not 9612 as previously reported.

Private Letter Rulings and Cases

PLR 9816018 – discusses eligible basis financed by tax exempt bonds.

PLR 9820015 – discusses correction of an administrative error that reduced the eligible basis of one building in the project.

PLR 9822026 – discusses qualification of the cost of a community building as eligible basis. Tenants were not charged a separate fee for use of the day care facility.

PLR 9830005 – discusses an exception to the 10-year holding period.

PLR 9831034 – discusses a carryover allocation that specified an incorrect number of buildings in the project.

PLR 9948025 – discusses why use of residential units for after school care rooms qualifies them as a common area functionally related to the project.

Richard E. Carp & Minda G. Carp v. Commissioner, T.C. Memo 1991-436 – discusses whether an amount designated as a development fee constitutes a qualified rehabilitation expenditure. The taxpayer failed to provide evidence that the expenditures were for the claimed purposes and did not submit sufficient evidence to enable an allocation under *Cohan*.

Fair Housing Act: Memorandum of Understanding Between HUD, Department of Justice and Treasury

A new Memorandum of Understanding (MOU) intended to promote compliance with the Fair Housing Act by LIHC property owners was signed by Housing and Urban Development (HUD), the Department of Justice (DOJ), and Treasury on August 11, 2000. The MOU will become effective on September 11, 2000.

The Fair Housing Act prohibits discrimination in the sale, rental, financing or advertising of housing on the basis of race, color, religion, sex, family status, national origin, or disability. The Act applies to conventional, as well as government subsidized, multi-family residential buildings, and includes LIHC properties.

The MOU includes provisions for HUD and DOJ to provide training and technical assistance to the IRS concerning civil rights and discrimination matters relating to the LIHC program and the IRS will provide technical assistance and training to HUD and DOJ regarding administration issues surrounding the LIHC program. In addition, the three agencies and other interested federal agencies will meet to discuss issues and ways to increase compliance with the Act. HUD and DOJ will also be working more closely with the state agencies

and providing training for developers, architects, property managers, and syndicators.

In addition to training and education activities, the MOU also provides for the coordination of owner/taxpayer notification procedures. HUD and DOJ will notify state housing agencies when:

- HUD has made a charge that the Act has been violated
- A probable cause finding under a substantially equivalent fair housing state or local ordinance has been made by a state or local agency
- A law suit has been filed by DOJ under the Act
- A settlement agreement or consent decree has been entered into between HUD or DOJ and the property owner

In turn, the state housing agencies will report this information us using Form 8823. The taxpayer will then receive notification that an adverse decision may result in the loss of low income housing tax credits. HUD and DOJ will also provide the IRS with information on the nature and dates of violations.

The MOU has been well received within the LIHC community; it emphasizes the participation of each segment of the industry, focuses on education, and provides an opportunity for continuous dialogue among the state housing agencies and the federal government.

More information about the Fair Housing Act is available at the HUD website “www.hud.gov”.

Thanks and Best Wishes.....

A special note of thanks to Ms. Eleanor Scott, LIHC Coordinator in the former Georgia District, who prepared this newsletter. Eleanor has now retired and we wish her well in her post-IRS endeavors.

♪ Grace Notes ♪

As we begin FY 2001, it is appropriate to talk about priorities for the LIHC Program. One of our top priorities, in keeping with the new Internal Revenue Service Mission, is providing timely and quality service to members of the LIHC community. We can achieve this through enhanced communication with the taxpayer community and providing support to the state agencies.

One way to enhance our communication strategy is through the development of an Internal Revenue Service website where taxpayers can find PLRs, Revenue Procedures and Revenue Rulings, the ATG and position papers specific to LIHC issues. Hopefully, the site will eventually be interactive so that we can respond directly to taxpayer questions. (We are looking for volunteers for this project. If you would like to help, please call me at (202) 343-0070.)

We can improve communication at the local level through presentations at conferences and meetings. Coordinators may be asked to accompany National Office, or even fly “solo”. Don’t panic!!! We will work with you to develop topics and content for any assignments.

Taxpayer service can be significantly enhanced by working with the state agencies responsible for allocating the credit and monitoring program compliance. It is my experience that taxpayers and the state agencies are actively interested in keeping LIHC properties in compliance with IRC §42 requirements. If we develop harmonious working relationships with the agencies and are easy to talk to, taxpayers will feel comfortable enough to approach us when they have questions, eliminating potential compliance problems, rather than feeling it’s an “us versus them” situation.

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