

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!!

IRS Chief Counsel recently released Revenue Ruling 2003-38 to answer frequently asked questions. While not all 12 questions are included in this newsletter, we want to alert you to those that will immediately affect the on-going operation of a LIHC building.

Frequently Asked Questions (The Management Company's Side)

Question 1: The first tenant for a newly constructed LIHC unit moved in on the last day of a month during the first year of the credit period. The unit was correctly rent-restricted and complies with all the requirements under IRC §42. There is a special rule for determining the Applicable Fraction for the first year based on a month-to-month consideration of occupancy. Is a unit occupied only the last day of the month treated as a low-income unit for that entire month?

The answer is provided in Rev. Rul. 2004-82, Q&A #4. Yes, the unit is treated as a low-income unit for the entire month if an income-qualified tenant resides in the rent-restricted unit on the last day of the month. However, the building must have been placed in service for the full month.

Question 2: The Vacant Unit Rule requires owners to make reasonable attempts to rent vacant LIHC units before renting market rate units. What are reasonable attempts?

The answer is provided in Rev. Rul. 2004-82, Q&A #9. The determination is made on a case-by-case basis, considering the facts and circumstances, and may differ from project to project depending on factors such as the size and location of the project, tenant turnover rates, and market conditions. Also, the different advertising methods that are accessible to owners and prospective tenants would affect

what is considered reasonable. Question 9 in the revenue ruling included the following examples:

- banners and for rent signs at the entrance to the project,
- classified advertisements in local newspapers,
- maintaining a waiting list and contacting prospective low-income tenants, and
- using a local public housing authority list of Section 8 voucher holders to identify and contact potential tenants

Question 3: Is a signed, sworn self-certification by a tenant sufficient documentation to show that the tenant is not receiving child support payments?

The answer is provided in Rev. Rul. 2004-82, Q&A #12. Yes, a signed, sworn self-certification by a tenant is sufficient documentation to show that a tenant is not receiving child support payments. In addition, the self-certification should indicate whether the tenant will be seeking or expects to receive child support payments within the next 12 months. If the tenant possesses a child support agreement but is not presently receiving any child support payments, the tenant should include an explanation of this and all supporting documentation such as a divorce decree and court documents to enforce payment. Also, the self-certification should indicate that the tenant will notify the owner of any changes in the status of child support.

A housing credit agency's monitoring procedure, however, may not permit an owner to rely on a low-income tenant's signed, sworn statement if a reasonable person in the owner's position would conclude that the tenant's income is higher than

the tenant's represented annual income. In this case, the owner must obtain other documentation of the low-income tenant's annual child support payments to satisfy the documentation requirement.

In addition, a housing agency's monitoring procedure may continue to require that an owner obtain documentation, other than the signed sworn statement to support a low-income tenant's annual certification of child support payments.

Frequently Asked Questions *(The Taxpayer's Side)*

Question 1: State agencies require applicants to pay a nonrefundable application fee. If the state agency selects a project, an additional allocation fee is payable to the agency. Are the application fee and allocation fee includable in the eligible basis of the owner's low-income housing building?

The answer is provided in Rev. Rul. 2004-82, Q&A #3. Neither fee is includable in the eligible basis for computing the credit because the fees are not included in the adjusted basis used for computing depreciation. However, depending on the facts and circumstances, all or a portion of these fees may be required to be capitalized as amounts paid to create an intangible asset, or are deducted as an ordinary business expense.

Frequently Asked Question *(The States' Side)*

Question 1: The state agencies are responsible for monitoring LIHC properties for noncompliance with the requirements of the LIHC program and at least once every three years are required to review the tenant files and perform a physical inspection of the property. How long must the state agencies retain the documentation of the review and any forms 8823?

Under Regulation 1.42-5(e)(3)(ii), an agency must retain records of noncompliance or failure to certify for six years beyond the housing agency's filing of the respective Form 8823. In all other cases, the agency must retain the

certification and related documents for three years from the end of the calendar year in which the agency receives them.

Question 2: And what about all the records that an owner must keep; can an owner comply with the recordkeeping and record retention provisions under Treas. Reg. 1.42-5(b) by using an electronic storage system instead of maintaining hardcopy (paper) books and records?

The answer is provided in Rev. Rul. 2004-82, Q&A #11. Yes, provided that the electronic storage system satisfies the requirements of Rev. Proc. 97-22. However, *and this is really important*, complying with the recordkeeping and record retention requirements of the Service does not exempt an owner from having to satisfy any additional recordkeeping and record retention requirements of the monitoring procedure adopted by the housing agency. For example, the housing agency may require the taxpayer to maintain hardcopy books and records.

For the basic requirements of maintaining records in an automated data processing system, including electronic storage systems, see Rev. Proc. 98-25, 1998-1 C.B. 689.

New Procedures for Income Recertification Waivers Under Revenue Ruling 2004-38

Owners of LIHC buildings are required to recertify each low-income household at least annually. The recertification process is identical to the initial certification in terms of documenting household composition, income, and income from assets. Owners must also verify income with third party sources to confirm that the tenant is disclosing all income.

Under IRC §42(g)(8)(B), the IRS may waive the requirement to complete annual income recertifications if the entire building is occupied by income qualified tenants. The waiver limits the intrusiveness of annual recertifications for the tenants and lowers the costs of recertification for the building owner.

Rev. Proc. 2004-38, effective for applications filed with the IRS after July 6, 2004, introduces

new procedures for obtaining the waiver. Waivers granted under Rev. Proc. 94-64 are still valid.

New Form

A new Form 8877 is used to document the owner's request for the waiver and facilitate timely approval by the IRS. Two important items have been added:

First, the state agency must confirm that the building is 100% low-income and provide the owner with an exemption from their annual income recertification requirements. The state agency's signature on the form replaces the separate statement formerly required under Rev. Proc. 94-64.

Second, the owner must agree to IRS disclosure of any subsequent revocation of the waiver to the state agency. The consent is included as Part II of the Form 8877. The IRS will not approve a waiver unless the owner has signed the disclosure consent.

Effective Date

The waiver is now effective on the date it is signed by the IRS, which is much earlier than the effective date under Rev. Proc. 94-64. It remains in effect for the remainder of the 15-year compliance period, unless it is revoked.

Grounds for Revocation

The waiver may be revoked for three reasons:

1. the state agency requests that the waiver be revoked,
2. the building ceases to be 100% low-income, or
3. the IRS determines that the owner has violated IRC §42 in a manner sufficiently serious to warrant revocation.

The waiver is automatically revoked if there is a change in ownership (including a termination under IRC §708). The new owner may apply for a waiver.

Tracking LIHC Exam Cases

Please make sure that your LIHC cases are properly identified for tracking purposes. Project Code is 670, the Tracking Code is 9812, and there should also be a "Y" Freeze Code. Should it become necessary to survey a LIHC return, please complete Form 1900 and submit to Program Analyst Grace Robertson for approval. The form can be transmitted by e-mail or fax to (202) 283-2240.

♪ Grace Notes ♪

Every morning I eagerly open my e-mail, curious to find out whether someone has sent me an "interesting" LIHC question. Not long ago, I was asked why the IRS uses the acronym LIHC rather than LIHTC - like the rest of the world.

Well, not that the IRS is egocentric or anything, but including "T" in the acronym would be rather redundant for us - everything we do revolves around taxes - and of course a credit is a tax credit!

For the affordable housing industry, the story isn't quite so easy. There is a multitude of financing options to complement the IRC §42 incentive for equity investment - including, in some part of the country, a state income tax credit. Including "T" in the acronym really does help clarify what the credit is referencing.

As for the title of this newsletter - well, I'm a very efficient person and four key strokes for LIHC is one less the five for LIHTC! Given the number of times I type that acronym virtually every day - I must save at least three minutes of work every day!

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P.S. August is a traditionally quiet month here in DC. It is extraordinarily quiet this year! Hope you are all enjoying a very restive holiday.