

# 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!!*

## **Auditing Eligible Basis**

*By Kent Rinehart, Program Analyst*

In non-LIHC real estate rental projects, there's no need to worry about "Eligible Basis"—only the total cost of construction. For an LIHC project, total cost of construction does not equal Eligible Basis. There are costs that are not included in the Eligible Basis used to compute the amount of allowable LIHC. These costs may not be eligible because of their character, the timing of the expenditure, or because of the type of funding used to pay for the cost. In short, Eligible Basis is a term unique to LIHC (IRC §42) projects. Here are some steps to help identify the costs to which the credit applies.

### **Step 1: Is the cost "depreciable"?**

To be eligible for LIHC, the cost must be depreciable. For example, land costs are not included in Eligible Basis. Neither are expenses related to permanent financing (loans) for the project, syndication fees, or costs related to the selling of an equity interest in a project. These costs must be either permanently capitalized, expensed, or amortized, depending on their tax purpose as provided in the Internal Revenue Code.

### **Step 2: Is the cost associated with residential housing?**

To be eligible for Eligible Basis, the cost must also be for residential housing. This includes the costs of personal property for use by the households, such as appliances. It can also include the cost of facilities, such as garages, swimming pools and parking lots, as long as there is not a separate fee charged for the use of the facility and the facility is available to all households. For example, if the project consists

of 100 units (or households), but there are only 30 garages available, the garages are not considered residential housing and cannot be included in eligible basis.

### **Step 3: Is the cost related to the construction of a new building or the substantial rehabilitation of an existing building?**

The main thing to be aware of here is the timing difference between these two types of buildings. New building owners will make an election as to when their LIHC credit period will begin. Their eligible basis costs must be incurred by the close of the taxable year so elected.

For existing buildings with substantial rehabilitation, the cost of the acquiring the building is included in eligible basis. Substantial rehabilitation is defined in IRC §42(d)(2)(D) to mean amounts that equal or exceed 25 percent of the adjusted basis of the building. However, the owner elects a 24-month period, during which to incur and perform the substantial rehabilitation and these Eligible Basis costs end on the last day of the 24-month period elected.

### **Step 4: In which year does the LIHC credit period begin? [IRC § 42(d)(1)]**

As indicated above, new building owners make an election that starts the LIHC credit period. IRC §42(d)(1) provides that the Eligible Basis of a new building is its adjusted basis as of the close of the 1<sup>st</sup> taxable year of the credit period. If an owner elects to claim the credits starting the year the building is placed in service (or, checks "no" on line 10a of Form 8609), the Eligible Basis is limited to all costs incurred as of the close of the year the building was placed in service. As a result, certain costs that may have been incurred

after that time (e.g. landscaping, common areas, etc.) cannot be considered part of eligible basis.

If the taxpayer elects to postpone the beginning of the credit period for a year, then the taxpayer may incur more expenses after the end of the year in which the building was placed in service. There are many reasons why a taxpayer may elect to postpone the beginning of the credit period and the taxpayer should be asked why.

#### **Step 5: What type of financing for construction is involved?**

IRC § 42(d)(5) and Treas. Reg. § 1.42-16 provide that 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 the grant is funded with federal funds, the eligible basis of the building for the taxable year and all succeeding taxable years is reduced by the portion of the grant that is so funded. Therefore, for any federal grant included as part of financing, ensure that the Eligible Basis has been reduced for such amount.

#### **Step 6: What costs are, or are not, eligible?**

In its simplest context, if the cost is directly attributable to the depreciable, residential rental property, then it should be included in Eligible Basis. For example, costs such as engineering studies, architectural specifications, pertinent legal and accounting fees, construction period interest and taxes, and general contractor fees are most often found to be directly attributable to building costs.

The costs associated with the primary residential buildings are generally pretty easy to identify and often include expenditures for accent features (like a gazebo) and landscaping directly around and adjacent to a LIHC building. As a rule of thumb, consider whether the accent feature or landscaping would be destroyed in the event a building needed to be razed. If so, then the cost is sufficiently attributable to the building to be included in Eligible Basis.

#### *Developer Fees*

Developer fees are generally included in Eligible Basis provided that the fee is reasonable. Most of the state agencies have set limits on the amount of developer fee that can be included, and the IRS generally honors these limits as “reasonable”. Just be sure that any notes for developer fees actually represent debt and payment is not contingent upon the performance of the property over time – if payment is contingent on performance and the developer is also the managing partner, then the fee is really for successfully managing the property and is characterized as an operational cost. Most likely, there should also be an allocation to associate at least part of the developer fee to activities such as buying the land, syndicating the credit, and putting together the partnership. Developer fees that are essentially paid to-and-from the same person or paid to related party warrant closer scrutiny.

#### *Land Improvements*

Other costs an owner may consider attributable to their residents may require a more in-depth analysis. For example, a retention pond, no matter how beautiful, is still a retention pond and its costs are associated with land. Also, most costs of getting land in suitable condition for construction (grading and reshaping, filling, excavating, dynamiting, etc.) are also considered land costs and are not includible in eligible basis.

#### **Conclusion**

In looking at eligible basis overall, a good starting point is with the local state housing agency to see how the taxpayer presented the costs in their final cost certification. Here, you can determine what costs were excluded from eligible basis on the front-end by and whether the taxpayer had access to federal grants or loans. At this point, reconcile the taxpayer’s books and records and the actual final costs and determine whether or not the taxpayer included them in Eligible Basis. It is not uncommon to discover a taxpayer that has a higher Eligible Basis than what was originally conveyed to the state, however, it is important to follow the steps above to ensure that each cost is includable.

## Private Letter Rulings

By Grace Robertson, Program Analyst

Got a tax question about your LIHC property? What do you do? Call someone, of course. And after calling several people, and no one knows the answer, someone inevitably suggests that you request a private letter ruling. Sounds absolutely like something you really don't want to ever do this side of recapturing credits, but at some point it become inevitable. So, what's a private letter ruling anyway? Here's the "condensed" answer.

### *Private Letter Ruling (PLR) Defined*

A PLR is a written response issued to a taxpayer when the taxpayer asks a question (in writing) about the tax effects of its acts or transactions. The PLR interprets and applies the law to the taxpayer's specific set of facts and the taxpayer who requested the PLR can rely on the conclusions expressed in a private letter ruling. You cannot rely on a PLR issued to another taxpayer, no matter how similar the fact pattern. Private letter rulings for IRC §42 credits are under the jurisdiction of the Associate Chief Counsel (Passthroughs and Special Industries).

### *Annual Revenue Procedure*

Updated instructions for submitting a request for a private letter ruling are provided as the first Revenue Procedure of each calendar year; e.g., this article is a summary of Rev. Proc. 2005-1.

### *When to Request a PLR*

The PLR should be requested prior to the filing of the tax return on which the tax effects or transaction at issue are to be reported. If you do file a return reflecting the issue after requesting a PLR, you must notify the Associate Counsel and attach a copy of your request to the tax return.

Generally, the Service will not issue a PLR to a taxpayer if the issue is being examined on the taxpayer's return for an earlier year, is being considered by Appeals on the taxpayer's return for an earlier year, or is included in a pending Tax Court case involving the taxpayer. There are (of course) exceptions to the rule, but the basic idea is

to request the private letter ruling before the tax return is filed.

The Service may decline to issue a letter ruling when appropriate in the interest of sound tax administration or on other grounds, whenever warranted by the facts or circumstances of a particular case. As an alternative, the Service may issue an information letter calling attention to well-established principles of tax law.

### *Content*

While the format of a private letter request is not dictated, specific information must be included with a request for a private letter ruling.

1. Complete statement of facts, including:
  - (a) Identification of all interested parties,
  - (b) Disclosure of annual accounting periods,
  - (c) Description of the business activity, business reasons for asking the question, and
  - (d) Detailed description of the problem for which the request is being made.
2. Documentation to support those statements; i.e., contracts, agreements, etc., that are pertinent to the issue. Translations of documents written in foreign languages must be included.
3. An analysis of the facts and explanation of why they are important to the issue.
4. Statement that none of the taxpayer's tax returns, or the tax returns of related parties that might be affected by the outcome, are under audit, before Appeals, or before a federal court. You must also notify the Associate Counsel if an audit is started after submitting the request.
5. Statement that no PLR was previously requested by the taxpayer or ruled upon for the same or similar issue, nor is a PLR pending on the same or similar issue. You must also notify the Associate Counsel if another PLR is submitted after submitting this request.

6. Identify the authorities that you believe support your position; i.e., sections of the Internal Revenue Code, etc. Of course, you are also expected to identify and discuss any contrary authorities, tax treaties, and pending legislation pertinent to the issue. Presenting both sides helps Service personnel understand the issue and relevant authorities more quickly. You must also notify the Associate Counsel if you become aware of relevant pending legislation after submitting this request.
7. Since private letter ruling are made available to the public, you also need to identify any information that you want deleted from the copy provided to the public.
8. Requests must include a statement, under penalties of perjury, that the information provided contains *all* the relevant facts relating to the request, and that such facts are *true, correct, and complete* to the best of your knowledge and belief. This statement must be signed by the taxpayer –not a representative. Just like signing your tax return.
9. Requests for private letter rulings must be signed and dated by the taxpayer or taxpayer’s representative. If your representative signs the request, be sure to include a completed Form 2848, Power of Attorney and Declaration of Representation.
10. To help make sure your request is complete, Chief Counsel provides a checklist, which is also completed and submitted with the request.

#### *Procedures*

- How many issues am I addressing in my request? The Service may issue separate rulings upon request.
- How many copies of my request do I need to submit? Generally, you need to submit the original request and one copy. If more than one issue is included in the request, submit additional copies.

- You can request a “two-part” letter ruling if requesting a particular conclusion.
- You can request expedited handling, but it is granted at the Service’s discretion and, in fairness for all taxpayers, only in rare and unusual circumstances.
- You can request a pre-submission conference (by telephone or in person) to informally discuss the technical or procedural aspects of the issue.
- You can request a post-submission conference to discuss the issue when you submit the request, or in writing soon after.
- The request for a private letter can be submitted using normal mail, private delivery service or hand delivered. You will receive an acknowledgement letter.
- There is a user fee for submitting private letter ruling requests, payable with the submission. Beginning on March 1, 2005, the cost is \$7,000. Departments, agencies, or instrumentalities of the U.S. are exempt from the user fee requirement if they certify that they are seeking a letter ruling on behalf of a program or activity funded by federal appropriations.

#### *Then What Happens?*

Within 21 days, you (or your representative) will be contacted to discuss procedural issues, and where possible, technical issues such as how the Associate Counsel may rule on the request, if additional information is needed, or if modification of the facts would render a more favorable outcome.

You may withdraw your PLR request at any time before the ruling is signed by the Service, but the user fee ordinarily is not returned. However, if the Associate Counsel declines to issue a ruling, the user will be returned.

Once completed, the private letter ruling will be sent directly to the taxpayer. The Service may send copies to the representatives designated on Form 2848, but not more than two. The Associate Counsel also sends a copy to the Service official

that has examination jurisdiction over the taxpayer's tax return.

The PLR should be attached to the affected tax return when it is filed. If your tax return has already been filed, the PLR should be included on an amended return or claim for refund.

#### *Revoking or Modifying a PLR*

A taxpayer may be audited after a PLR is issued. The audit will include determining whether the PLR conclusions are correctly reflected on the return, whether the representations upon which the PLR was based are accurate, whether the issue was resolved as proposed, and whether there has been change in the law that applies to the issue or any continuing series of issues stemming from the PLR. The Associate Counsel may revoke or modify a PLR based on the results of an audit it is determined to be in error or there has been a change in law.

### **Monitoring LIHC Cases**

Project Code 0670 has been established for LIHC audits. If you expand an audit to include additional years or taxpayers, please remember to update the Project Code on the new returns. Same for the Tracking Code, which is 9812.

Should you need 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 faxed to (202) 283-2240.

## ♪❤️♪ *Grace Notes* ♪❤️♪

*It was Valentine's Day - really rainy and depressingly gray outside, and I was not looking forward to a long drive home. It had been a busy day full of distractions, and as I hurriedly multi-tasked through assignments, my mind drifted, I found myself thinking back to Valentine's Day when I was in the second grade - when the most urgent task was delivering Valentine cards and running back to my desk to count the dime store cards that I had received in return. It's really rather silly, isn't it - Valentine's Day Cards given to somehow provide tangible evidence of a much deeper immeasurable emotion?*

*For some unfathomable reason, I thought about the box of business cards I keep on my desk. You know, all the cards from meetings and conferences -most of them given to me with a "call me if there's anything I can do to help" look and a smile. And I remembered the day someone called me, very distressed, with a problem that I just didn't have a clue how to handle... and there, on the top of the pile was just the name I needed. And then I realized that the very card I needed was there more than just once or twice.*

*And being the sentimental person I am, my box of business cards suddenly seemed like a box brimming over with the sincerest Valentine's Day cards an IRS analyst could ever wish for, because people really do reach out and help when I call them.*

*So, although it may be a bit late, my sincere thanks and appreciation to those who have helped me, and helped me help others. And if I haven't called you yet, consider yourself warned!*

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