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!!

Congress Ups the Low Income Housing Credit Cap

Congress approved, and President Clinton signed, the Community Renewal Tax Relief Act of 2001, which included the following three changes to IRC section 42 which will immediately impact IRS audits of low income housing project. The Act also included significant changes to the qualified allocation plan and other state housing agency responsibilities. The changes are effective for credit allocations made after December 31, 2000.

- The per capita credit ceiling (currently $1.25) has been increased to $1.50 for 2001 and $1.75 for 2002. Thereafter, there will be a cost of living increase each year. It has been estimated that the increase will support an additional 180,000 low income housing units over the next five years. Further, the new law also establishes a minimum LIHC allocation for states with smaller populations: $2,000,000 in 2001 and 2002. The minimum allocation is also indexed to the cost of living. The minimum allocation will be applicable to 12 states, the District of Columbia, and the Virgin Islands in 2001.

- The deadline by which a project must meet the 10% test has been extended for projects receiving a credit allocation after July 1; the deadline is now six months after the date of the credit allocation.

- The adjusted basis (for purposes of computing the LIHC) of any low income building located in a qualified census tract can include the portion of adjusted basis of property (not to exceed 10%) used throughout the taxable year as a community service facility designed to service individuals whose income is 60% or less of the area median income. Facilities, for example, could be used for childcare centers, senior citizen programs, or job training services.

15 to 30 Years of Due Diligence After LIHC is Received

by Kent Rinehart, Revenue Agent

During the next two years, allocations of Low-Income Housing Credit (LIHC) will increase 40% over their current levels. With the competition for existing credits already widespread and intense, future applications for LIHC will be even more competitive.

I am impressed with the extent of due diligence, time and effort exerted by owners and developers when preparing their credit applications for consideration by the state agencies. During this time, owners and developers work their way through all the necessary paperwork associated with the state's application process. They also do extensive research, planning, and follow-up with the state. Finally, their efforts are rewarded with the issuance of Form 8609, Low-Income Housing Credit Allocation Certification, for their completed project!

It is at this point, however, where I have seen a sudden and distinct drop off in the due diligence exerted by owners and property managers to maintain their project according to the states requirements and IRC Section 42. Due diligence is defined *(Black's Law Dictionary [6th ed. 1990])* as: "Such measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstances; not measured by any absolute standard, but depending upon the relative facts of the special case." In short, the due diligence standard is a judicially created test to determine the adequacy of the efforts exerted throughout all phases of any activity, including the LIHC program.

As part of my audit, I include a comparative analysis to ensure that taxpayers' due diligence is consistent throughout the entire LIHC project commitment. This includes checking due diligence for each of the following phases:

- LIHC Application and Development Process

The application/development process generally sets the standard for the level of due diligence the IRS expects to see throughout all phases of the project. Once a taxpayer has the credit allocation, I expect the taxpayer to continue with this same level of due diligence.

- During the Tenant Screening Process

I analyze the internal controls, personnel actions taken, and the care and oversight demonstrated during the critical initial lease-up period to determine if the taxpayer is continuing to exercise due diligence. How well does the property manager ensure that all adults' income is identified? How well does the property manager make inquiries regarding additional roommates when there are more bedrooms in the unit than tenants occupying the unit? How well does the property manager follow-up and verify the information provided by the tenants? I'm looking for evidence of the taxpayer's intent to provide qualified low-income housing—not just to secure the tax credits.

- Rental Monitoring and Property Maintenance

I also analyze the due diligence demonstrated by the property manager in overseeing all the physical aspects of the rental units and all other land, buildings, equipment and services that comprise the LIHC project. I check to see if the state housing agency or state inspectors noted any concerns or violations of health, safety, or building codes. Are all buildings and equipment in good shape or are they in need of repair? Is the property clean and safe or are there visible problems that appear to be creating unsafe or unhealthy conditions for tenants? How often does the property manager make physical inspections of the rental units? Further, I want to know how "problem" tenants are being handled. Does the property manager take prompt, remedial action to correct the tenant's behavior or do they look the other way and allow such conduct to continue? I can then make a determination as to the quality of housing, maintenance, and services provided by the property manager.

- Tenant Recertifications

I first review if the state issued any notices for late tenants recertifications. I want to ensure that a complete and accurate recertification is done rather than a property manager simply going through the motions, especially for qualified households that are good renters what pay timely and don't cause problems. How well does the property manager inquire about changes in household size or job status? Have any of the property manager's physical inspections identified changes in household size (e.g., more tenants in a unit than who initially applied, etc.). Overall, the recertifications are an annual requirement to keep the credit. A lot can happen to any household during the year and I just want to ensure that these recertifications are handled in the same manner as the initial tenant screening was done.

- Final Years of the Compliance Period

Due diligence becomes even more important once the project gets into its 11th full year of operation. All of a sudden, the LIHC incentive is gone! Generally, at this point, there are no more LIHC tax benefits, yet the property remains low income housing for the next five years. In addition, for all building allocated tax credits after 1989, IRC Section 42 requires owners of tax credit properties to enter into an extended use agreement. All in all, the taxpayer has made a commitment to maintain the property as a low income housing project for at least 30 years. Therefore, if the owner conveys to the state housing agency that they will maintain the LIHC property for 15 or 30 years, then I would expect them to maintain it all throughout this time with the same level of diligence that they acquired the LIHC from the state housing agency.

Overall, the IRS expects to see a high level of due diligence demonstrated throughout the entire LIHC commitment period. Anything short of that could result in changes to the low income housing credit during an audit.

Revenue Agents Attend NCSHA's Southeastern Regional Conference

By Betty Graydon, LIHC Coordinator

National Council of State Housing Agencies' Southeastern States met November 16-17, 2000 in Lexington, Kentucky to discuss LIHC issues of

common interest. The states were represented by staff from both their Credit Allocation and Compliance Monitoring areas. Revenue agents from Florida, South Carolina, and Virginia were invited to attend, as well as the Headquarters analyst for the LIHC program. The conference was conducted in a roundtable format, which was conducive to open discussions and participation among the participants.

An in-depth presentation was made on the TAMS, providing definitions of the different types of construction costs at issue and explanations of the law and its application to low income housing credit projects. Some of the issues discussed included:

- How the five recent TAMS addressing land costs would affect the 10% Test

Projects requesting carryover allocation are not affected. As stated in IRC 42(h)(1)(E), it is "10 percent of the taxpayer's reasonably expected basis in such property". The Code does not specify "eligible" basis; i.e., all costs (land and building) are included when determining whether 10% of the costs have been incurred.

- How the five TAMS addressing land costs would affect the allocation process and final certification of costs by the state agencies

We requested that the state agencies alert owners submitting their final cost certifications that they should carefully consider the guidance provided in the position paper. Taxpayers are subject to future audit and must correctly determine their eligible basis and limit the credit amount accordingly when filing their tax return. Taxpayer may wish to voluntarily amend their credit allocation request to reflect a revised basis. These requests should be honored and the credit amount adjusted accordingly.

- How to monitor compliance after the end of the 15-year compliance period.

The extended use agreements are the primary enforcement tool after the end of the 15-year compliance period. The agreements represent a contractual arrangement between the state agency and the owner and are governed by state law. State agencies can pursue civil action to enforce performance of the agreement, as well as modify or even terminate, an extended use agreement without IRS involvement. State agencies are cautioned, however, that they may be subject to civil suit by displaced or harmed tenants, another owner, or even an applicant who did not receive a credit allocation, when an extended use agreement is modified or terminated.

Land Value: What's Your Guess?

By Eileen Jones, Revenue Agent

The review of a partnership return showed a land value of $32,000 on the balance sheet and an eligible basis of $4,218,966 on Form 8586. The land value was selected as an audit issue and the following information was determined:

- One of the partners purchased the property for $1,325,000 in 1990.

- The same property was sold to a partnership for $1,700,000 eighteen months later in 1991. A due diligence report prepared by the partnership included a county appraisal listing the land value as $264, 300. Thus, according to the partnership, the value of the property increased $375,000 (1,700,000 – 1,325,000), while the value of the land decreased $232,300 (264,000 – 32,000) during the same time period.

- The credit application to the state housing agency listed the land value as $170,000.

- The general ledger land account had a beginning balance of $195,670.93. The ending balance was $32,000.

- An IRS engineer valued the land and determined a value of $255,000.

According to the partnership, the land value of $32,000 is based on an independent appraisal they had done in 1993. Their explanation for the other figures is that that the valuations are guesses made by non-experts. We, of course, are going with the $255,000 value, as determined by the IRS engineer.

(Editor's Note: if you would like to talk with an Engineer about land valuation, you can call Tom Kelley at (651)726-1512 .)

TAM's and PLR's

TAM 200044004 (July 14, 2000) Subject to some assumptions, a note for developer fees is includable in a partnership's eligible basis.

TAM 200044005 (July 14, 2000) Whether land preparation, construction loan, and construction contingency costs that a limited partnership incurred for a low-income housing project can be includable in eligible basis.

TAM 200043015 (July 14, 2000) Costs associated with the issuance of tax-exempt bonds used to finance the construction of a low-income housing building are not includable in eligible basis.

TAM 200043016 (July 14, 2000) Local impact fees and construction loan costs that a partnership incurred in the construction of a low-income housing building are not includable in eligible basis.

TAM 200043017 (July 14, 2000) Developer fees and construction loan costs that a partnership incurred in the construction of a low-income housing building are not includable in eligible basis.

PLR 200044010 (July 28, 2000): An extension to elect to treat its residential rental property as a qualified low-income housing project was granted to a partnership.

PLR 200046033 (August 23, 2000): No recapture of low-income housing credits will occur from a company's untimely election to be treated as a C corporation.

PLR 200105038 (October 31, 2000): The 10-year holding period requirement is waived for a limited partnership's acquisition of a low-income housing project development.

Criminal Investigation: LIHC is Designated "Emerging Issue"

CID has designated the Low Income Housing Credit program an "emerging issue"; they have dedicated resources, provided training to their agents, and monitor the industry. About half their leads come from the U.S. Attorney, while the other half comes from revenue agents and state agencies.

Some of the common fraudulent activities include paying or accepting bribes, falsification of property eligibility, false compliance documentation, falsification of tenant eligibility or altering tenant applications, and inflating occupancy rates.

In one case, the taxpayer altered lease agreements and forged employee signatures to misrepresent tenant eligibility and the amount of rent tenants were paying. He was convicted of defrauding the government of more the $426,000 in tax credit over a three year period, sentenced to two years in prison, and fined $97,000 in penalties.

(Editor's Note: if you would like to talk with CID's senior LIHC analyst about potential fraud in the low income housing industry, you can call Charles Jenkins at (202) 622-5221.)

♫ Grace Notes ♫

Remember our MOU with the state agencies? Since it was first issued in 1999, 13 states have signed up. We have, or are finalizing, agreements with Kansas, Georgia, North Carolina, North Dakota, Florida, California, Oregon, Mississippi, Hawaii, Ohio Washington, Virginia and West Virginia. Four state agencies have decided not to participate: Alaska, Indiana, Missouri, and South Carolina. Thanks to all of you for your efforts!

We've received feedback from the states, and based on their comments, the MOU has been updated to include instruction for completing Form 8821, clarify that tax information disclosed under IRC 6103(c) is not subject to safeguarding requirements, and outline the privacy principles we feel are appropriate to preserve the confidential nature of the information we are providing and the taxpayer's privacy. These are the same privacy principles that you are subject to when conducting audits. We hope these updates encourage more states to participate in the MOU.

The updated MOU was distributed by memorandum on January 24,2001 and sent by e-mail to the LIHC Coordinators on February 6, 2001.

Again, thanks for all your help.

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