

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!!

Notice 2006-11: Relief from Certain LIHC Requirements Due to Hurricane Rita

On February 13, 2006, the IRS released Notice 2006-11. Similar to relief granted under Notice 2005-69, which addressed devastation caused by Hurricane Katrina, this notice includes:

1. *Temporary* suspension of income limitations for certain low-income housing projects approved by the state housing credit agency to rent vacant units to displaced individuals. The state housing credit agency will determine the appropriate period of temporary housing, but not to extend beyond September 30, 2006.
2. The non-transient use requirement will not be applied to any unit providing temporary housing for a displaced person during the temporary housing period.
3. All other rules and requirements of IRC §42 continue to apply during the temporary housing period.

To qualify for the relief offered under this notice, the following requirements must be met:

1. The displaced individual must have resided in a Louisiana or Texas jurisdiction designated for Individual Assistance by FEMA as a result of Hurricane Rita,
2. The owner must obtain the state housing credit agency's approval to provide temporary housing,

3. The owner must collect, certify and maintain documentation pertaining to each displaced person temporarily housed in the project,
4. The owner must list the project on the FEMA registry for assistance,
5. Rents for the low-income units housing displaced individuals must not exceed the rent-restricted rates for the low-income units under IRC §42(g)(2).
6. Existing tenants in occupied low-income units cannot be evicted or have their tenancy terminated as a result of efforts to provide temporary housing for displaced individuals.

Updated Regulations and Revised Forms 8609 and 8609-A, What's the Difference?

Beginning January 27, 2004, Treas. Reg. §1.42-1(h) stated, specific to Form 8609:

Filing of forms. [...] A completed Form 8609, "Low-Income Housing Credit Allocation and Certification," must be filed with the owner's Federal income tax return for each of the 15 taxable years of the compliance period. Failure to comply with the requirement of the preceding sentence for any taxable year after the first taxable year in the credit period will be treated as a mathematical or clerical error for purposes of section 6213(b)(1) and (g)(2).

This regulation was updated, beginning November 7, 2005, to state, specific to Form 8609:

Filing of forms. [...] Unless otherwise provided in forms or instructions, a completed Form 8609, “Low-Income Housing Credit Allocation and Certification,” (or any successor form) must be filed by the building owner with the IRS. The requirements for completing and filing Forms 8586 and 8609 are addressed in the instructions to the forms.

The important change is that the specific requirements for filing Form 8609 will be outlined in the instructions for the form rather than in the regulation.

Revised Form 8609

A month after updating the regulation, in December of 2005, the IRS revised Form 8609, Low-Income Housing Credit Allocation and Certification, to include the penalty and perjury statement and a signature line for the taxpayer at the bottom of Part II. (When the form was revised in November, 2003, these items were removed from the form so that partnerships owning LIHC properties could file tax returns electronically.)

The significance of this revision is that an owner will no longer complete the certification required under IRC §42(l)(1) by filing a completed Form 8609 each year with its tax return. Instead, all owners of IRC §42 properties filing tax returns for years 1 through 15 of the 15-year compliance period are required to make a **one-time** submission of the completed form to the IRS, even if the form was previously filed with tax returns. **Just file the one-page form –no attachments other than the list of buildings in a multiple-building project.**

Using Different Versions of the Form 8609

Since there are multiple versions of Form 8609 in use, the instructions for making the one-time certification are specific to the revision of the form.

Revision date of January 2000 or earlier – Send a copy of the completed and signed version of the form.

Revision date of November 2003 – Copy the information from the November 2003 revision onto the December 2005 revision. Include from

the “Signature of Authorized Housing Credit Agency Official” area on the November 2003 revision the name (but not the signature) of the authorized official and the date. Sign and complete the signature area of Part II of the December 2005 revision and submit it, and keep a copy for your records.

Revision date of December 2005 – After you have received Form 8609 with a completed Part I from the housing credit agency, complete and sign Part II and submit it. Part II must be completed and signed even if an allocation of credit by a housing credit agency is not required, as in the case of a building financed by tax-exempt bonds.

Buildings Financed with Tax-Exempt Bonds

The requirements for buildings financed with tax-exempt bonds have also changed. Temporary Treas. Reg. §1.42-1T(h) formerly provided an exception for low-income buildings financed with tax-exempt bonds. Specific to Form 8609, paragraph 2 read:

Manner of filing. [...] A completed Form 8609 (or copy thereof) shall be filed with the owner’s Federal income tax return for each of the 15 taxable years in the compliance period. If a housing credit allocation is not required to be received by an owner under paragraph (f) of this section, the owner shall obtain a blank copy of Form 8609 and fill in the address of the building and the name and address of the owner in Part I. Part II of Form 8609 shall be completed by the owner of the qualified low-income building only for the first year the low-income housing credit is claimed by the building owner. Part III of Form 8609 (statement of Qualification) shall be completed by the owner of the qualified low-income building for each year of the 15-year compliance period

Paragraph 2 no longer exists and Temporary Treas. Reg. §1.42-1T(h) now refers you to Treas. Reg. §1.42-1(h), which refers you to the instructions included with the form. The newly revised instructions state:

No housing credit allocation is required for any portion of the eligible basis of a qualified low-income building that is financed with tax-exempt bonds taken into account for purposes of the volume cap under section 146. An allocation is not needed when 50% or more of the aggregate basis of the building and the land on which the building is located ...is financed with certain tax-exempt bonds for buildings placed in service after 1989. However, the owner still must get a Form 8609 from the appropriate housing credit agency (with the applicable items completed, including an assigned BIN).

Submission to the IRS

Once completed and signed, the forms should be sent to the IRS at the following address:

Internal Revenue Service
P.O. Box 331
Attn: LIHC Unit, DP 607 South
Philadelphia Campus
Bensalem, PA 19020

Be sure to keep a copy of the completed forms for your records.

New Form 8609-A

In January 2006, Schedule A (Form 8609), Annual Statement, was replaced with Form 8609-A, Annual Statement for Low-Income Housing Credit. The format has been updated and the questions in Part I have been renumbered. The computation of the annual credit in Part II, lines 1-18, has not changed.

Form 8609-A is used to report compliance with the low-income housing provisions and calculate the low-income housing credit.

Form 8609-A must be filed for each year of the 15-year compliance period that begins after 2004. File one Form 8609-A for the allocation(s) for the acquisition of an existing building and a separate Form 8609-A for the allocation(s) of rehabilitation expenditures.

New Form 8823: Follow-Up Questions (and Answers)

In the last newsletter, we provided a brief summary of recent changes to Form 8823. Now the follow-up questions:

1. When should an amended Form 8823 be filed? If an amended Form 8823 needs to be filed, how should it be filed?

An amended Form 8823 is used to correct an error on a previously filed Form 8823. For example, an incorrect building identification number is used or the wrong category of noncompliance is selected.

The form should be completed just as if it was the original - the only differences should be that (1) the error is corrected, (2) the box for "amended form" is checked and (3) the date of signature. The state agency can also include an explanation in a cover letter to identify when the incorrect Form 8823 was filed and the nature of the change.

2. How long is the correction period and when does it begin?

Generally, the correction period is 90 days, beginning on the day the *owner* is notified of noncompliance. The period can be shorter; i.e., when severe physical deficiencies need immediate attention. The state agency can also extend the correction period to a total of 180 days.

3. If a state agency identifies multiple noncompliance issues at the time of inspection, and all the violations are corrected within the correction period, how should the Form 8823 be filed?

Select that category of noncompliance that best matches the noncompliance and check both the "out of compliance" and the "noncompliance correct" boxes.

4. How should noncompliance be reported if a building has multiple issues and some are corrected within the correction period and some are still outstanding when the correction period expires?

If filing a Form 8823 when some of the noncompliance remains uncorrected, but the noncompliance in other categories has been entirely corrected, the state should check both “out of compliance” and “noncompliance corrected” boxes if the noncompliance is *entirely* corrected, and just the “out of compliance” box for those categories where some noncompliance remained outstanding. The correction date on line 9 would be left blank since not all the noncompliance was corrected for *all* categories.

5. If the noncompliance isn't corrected within the correction period, but the noncompliance is corrected at a later time, do all issues need to be corrected before submitting an 8823 showing both the out of compliance and noncompliance corrected boxes marked?

Yes. State agencies should not wait for the owner to correct noncompliance. The initial Form 8823 indicating noncompliance must be submitted timely (within 45 days after the end of the correction period), regardless of whether the noncompliance is corrected. When filing subsequent Forms 8823 later, all noncompliance for the category must be corrected, and all categories of noncompliance must be completely corrected. In other words, all noncompliance must be corrected before a subsequent Form 8823 is filed. A state agency must file the “back in compliance” Form 8823 if the noncompliance is corrected within three years.

6. Form 8823 now identifies the amount of credit allocated to the building on line 5. How is that amount computed?

Enter the amount shown on Form 8609, line 5. If there are multiple Forms 8609, enter the total amount. Do not include Forms 8609 for which the compliance period has ended.

7. The low-income project includes multiple buildings with noncompliance issues. Can just one Form 8823 be filed for the whole project?

No. A separate Form 8823 must be filed for each BIN.

8. Category 10m, Owner failed to maintain or provide tenant income certification and documentation, has been removed from the list

of noncompliance categories. How should failure to maintain adequate documentation be reported?

Owners must provide documentation that the unit is occupied by an income-qualified household. If the owner cannot provide that documentation, then the household is not considered an income-qualified household. Therefore:

If the documentation is inadequate for the income certification upon initial occupancy, report the noncompliance under 10a, Household income above income limit upon initial occupancy.

If the documentation is inadequate for the annual income recertification, report the noncompliance under 10b, Owner failed to correctly complete or document tenant's annual income recertification.

9. The IRS has adopted HUD's Dictionary of Deficiency Definitions. Where can I find a copy? Must all deficiencies be reported?

The Dictionary of Deficiency Definitions is available at HUD's website: www.hud.gov. Just enter “Dictionary of Deficiency Definitions” in the search feature.

If using the Uniform Physical Condition Standards (UPCS) and the physical deficiency fits the description in the dictionary, the noncompliance must be reported, regardless of whether it is minor, major or severe.

If using local inspection codes and the physical deficiency fits the inspection code's description of noncompliance, the noncompliance must be reported.

In addition, remember that even if using the UPCS definitions for inspection, if a state agency becomes aware of a violation of a local code, it must be reported.

Computing Applicable Fractions: A Fundamental Math Puzzler

Under IRC §42(c)(1) the applicable fraction, or percentage of low-income units in a building, is determined as of the close of the taxable year.

The taxpayer must calculate the applicable fraction using both the Unit Fraction method and the Floor Space method, and then use the *smaller* of the two fractions to calculate the Qualified Basis.

Unit Fraction

The unit fraction is a straightforward computation. Without regard to size or amenities, a unit is a unit and the fraction is:

$$\frac{\text{Number of Low-Income Residential Units}}{\text{Total Number Residential Units}}$$

Floor Space Fraction

The floor space fraction is a bit more onerous, as the owner needs to know the floor space of every unit in the building, and which units are occupied by qualified tenants. Generally, we measure floor space in square feet (sq. ft.). Do not include the floor space of common areas, amenities, hallways, or any other space – just the actual floor space of the residential rental units.

$$\frac{\text{Total Sq. Ft. of Low-Income Residential Units}}{\text{Total Sq. Ft. of Residential Units}}$$

Decimal Places

Following the instructions for Form 8609, Schedule A, line 2, the Applicable Fraction should be carried out four decimal places. Hence $50\% = 0.5000$. Use accepted conventions to round the fifth decimal place; i.e., numbers 5 and higher will result in "rounding up" and 4 and lower are "rounded down." For example, 0.50005 rounds up to 0.5001 and 0.50004 rounds down to 0.5000.

Applicable Fractions and Noncompliance

To include a unit (or the floor space of a unit) in the numerator of the Applicable Fraction, the unit must be in compliance. Without discussing all the nitty-gritty details, there are four basic criteria:

1. The unit must be occupied by an income-qualified household (or last occupied by a qualifying tenant and currently made available for rent),
2. The unit must be suitable for occupancy based on the UPCS or local inspection standards,

3. The unit must be used other than on a transient basis (except for transitional housing under IRC §42(i)(3)), and
4. The unit must be rent restricted as defined in IRC §42(g)(2).

Applicable Fractions and the Minimum Set-Aside

The Applicable Fraction is used to determine how much LIHC the owner can claim for a *building* each year. However, in order to claim any credit, the owner must provide a minimum amount of low-income housing. This minimum amount of housing is known as the Minimum Set-Aside.

The owner makes two elections impacting the determination of whether the minimum amount of low-income has been provided.

Making the Minimum Set-Aside Election

First, the owner must decide whether to make at least 40% of the units available to individuals whose income is 60% or less than the Area Median Gross Income (the 40-60 Test) or to make 20% of the units available to individuals whose income is 50% or less than the Area Median Gross Income (the 20-50 Test). This election is documented on Form 8609, line 10c, and is irrevocable.

Defining a Qualified Low-Income Project

Second, the owner must decide how to group buildings together as a project. Low-income housing can be developed as a single building, multiple building on a single site, or multiple buildings on scattered sites (within a short period of time or in distinct phases). Any single or combination of these development opportunities will generally be called a "project". However, for purposes of IRC §42, the word "project" has a very specific meaning.

Basically, the owner must decide how to group the buildings together as a *project* for purposes of applying the Minimum Set-Aside rule. The exact language is in IRC §42(g)(1), which reads:

IN GENERAL – The term 'qualified low-income housing project' means any project for residential rental property if the project meets the requirements of subparagraph (A) or (B) whichever is elected by the taxpayer.

Subparagraph A is the 20-50 Test and subparagraph B is the 40-60 Test. The building will be treated as a single building project unless the owner elects to treat the building as part of a multiple building project on Form 8609, line 8b. In addition, the owner must attach a statement to the Form 8609 disclosing information about the project. Refer to the instructions for completing Form 8609, line 8b for the complete list of information.

Comparing the Two Rules

The Applicable Fraction and Minimum Set-Aside or two distinct rules, but because they both involve percentages, it can be confusing.

The Applicable Fraction is:

- Calculated as the smaller of the Unit Fraction method or the Floor Space Fraction method
- Applied at the building level
- Fluctuates from tax year to tax year during the 15-year compliance period.

The Minimum Set-Aside is:

- Always computed as a percentage of residential rental units,
- Applied at the project level
- A constant throughout the 15-year compliance period.

There are helpful mathematical relationships between the Applicable Fraction and Minimum Set-Aside for low-income buildings *if the Applicable Fraction is calculated using the unit fraction.*

- If the Applicable Fraction for each building in the project is equal to or greater than the Minimum-Aside percentage, then the Minimum Set-Aside at the *project* level is met.

- It is possible in multi-building projects for the Applicable Fraction of individual buildings to be less than the project's Minimum Set-Aside percentage and the *project* as a whole will still meet the requirement.

Converting 100% Low-Income Buildings to Mixed-Used Buildings

For any number of unanticipated reasons beyond an owner's control, an owner of an IRC §42 100% low-income building may decide that residential units should be rented at the market rate. But what's the effect on compliance with the requirements of IRC §42?

This is not intended to be a complete list of things to consider, but these issues come quickly to mind.

Available Unit Rule – every LIHC unit of comparable size or *larger* than the smallest market rate unit in the building occupied by a household with income more than 140% of the Area Median Gross income (or 170% in deep rent skewed developments) will lose its status as a low-income unit.

Income Recertification Waiver – if you have a waiver of the annual income recertification under IRC §42(g)(8)(B), determining which households are actually over-income might be difficult since you aren't even completing annual tenant income certifications. A unit is not considered a qualified low-income unit unless the owner can document that the household is income-qualified. And the waiver, under either Rev. Proc. 94-64 or 2004-38, will be revoked by the IRS.

Applicable Fraction – the owner must now track the square footage and status of every unit and calculate the Applicable Fraction using both the Unit Fraction and Floor Space Fraction methods. The applicable fraction will no longer be predictable from year to year.

Minimum Set-Aside – the grouping of buildings to form the project for purposes of meeting the minimum set-aside requirement also needs to be considered. Just how many units within the project can be rented at market rate without jeopardizing the entire credit?

Vacant Unit Rule – to be in compliance with this rule, reasonable attempts must be made to rent vacant low-income units (comparably

sized or smaller than the vacated units) to tenants having a qualifying income before any units are rented to nonqualifying tenants. This is a conundrum: how does an owner make reasonable attempts to rent vacant low-income units to income-qualified tenants when attempting to convert at least some of those vacant units to market rate?

Extended Use Agreement – the applicable fraction for the building for every year of the extended use period (at least 30 years), which includes the 15-year compliance period, must be identified in the agreement. If the owner wants to change the applicable fraction by converting units to market rate, the agreement must be updated. Add a meeting with the state agency to your list of things to do.

Recapture of Credit – converting units to market rate will result in a decrease in the building's qualified basis. Correct me if I'm wrong, but I'm pretty sure that this is a recapture event under IRC §42. The further you are along in the 10-year credit period, the larger the recapture amount will be. However, in years 12-15, after the end of the credit period, the amount of accelerated credit recaptured starts to decrease. Did I mention that there's a tax benefit rule under IRC §42(j)(4)(A) to consider? Add a meeting with the partners to your list of things to do.

When considering your options, be sure to identify all the outcomes and the potential impact on compliance. I've come up with seven major considerations without much effort. I'm sure the legal-eagles out there can come up with more interesting and subtle nuances.

Auditing Related Investor Returns

In addition to IRS efforts to identify and audit tax returns of LIHC properties warranting examination, the tax returns of investors in LIHC properties may also be identified for audit. The following analyses should be completed if you are independently auditing the return of an LIHC investor.

Required Filing Checks (Partnerships and Other Flow-Through Entities)

If your investor's return is a partnership, it is likely that the partnership has invested in multiple LIHC properties. The investment may be made directly as a partner in the partnership owning the LIHC property, or through tiers of flow-through entities.

1. Reconcile the amount of credit identified on Schedule K to the K-1s received from the partnerships through which the credit is flowing.
2. Since it is unlikely that an investor will have ready access to the returns from which the K-1s were received, determine whether those entities have filed tax returns using IDRS research (see IRM 4.10.5.2.1) if your investor has a significant interest in the entity. This analysis should be limited to the entities from which the investor received K-1s. If the entity has not filed a tax return, call Grace Robertson at 202-283-2516. To protect the Government's interest, the LIHC, losses, and deductions reported on the K-1 should be removed from the taxpayer's return
3. Review the taxpayer's portfolio of investments in LIHC properties and determine whether the taxpayer has disposed of any investments. The partners are subject to the recapture provisions of IRC §42(j).
4. Finally, determine whether the composition of the partnership has changed. Any partner leaving the partnership is subject to the recapture provisions of IRC §42(j).

Required Filing Checks (Corporations)

Complete the same analyses as for partnerships, except:

For (1), also reconcile the amount of credit claimed or carried forward into the tax year with the ordering rules in IRC §38(d) and carryforward/carryback rules in IRC §39.

For (3), determine whether the taxpayer has divested itself of any investments. If so, the recapture provisions under IRC §42(j) apply to your taxpayer.

Since corporations are not flow-through entities, (4) does not apply,

Required Filing Checks (Individuals)

Complete the same analysis as for corporations, and in addition, apply the passive activity rules under IRC §469.

Subscribing to the LIHC Newsletter

The LIHC Newsletter is distributed through e-mail, free of charge. If you would like to subscribe, just contact Grace Robertson at Grace.F.Robertson@irs.gov.

Administrative Reminders

All LIHC cases should include Project Code 670 and ERCS tracking code 9812. If you expand an audit to include additional years or related taxpayer, please make sure the additional returns also carry the LIHC project code and tracking code designation.

Surveying LIHC Tax Returns

If you believe it is appropriate to survey an LIHC return, please fax Form 1900 to Grace Robertson, at 202-283-2240, for signature approval.

♪ Grace Notes ♪

For some unfathomable reason, my work group was moved to a different floor in the building. I can no longer just brainlessly push the top button in the elevator in the morning and I have to consciously navigate through a new maze to get to my cubicle, which is now in the middle of the room. What's worse, I came back from lunch one day to find an IT person sitting at my desk gleefully installing the latest version of Office. For some inexplicable reason, the automatic upgrade didn't download through the server. Did you know that workers in France, who felt their livelihood threatened by automation, flung their wooden shoes (called sabots) into the machines to stop them? Hence, the word "sabotage".

I groaned with the realization that I'd been lulled into a false sense of security. I'd made a concerted effort to figure out all (well, most....okay, at least the critical features) of the last version. What more could be asked of an icon-challenged kid who learned to read phonetically? I know that a new version of Office doesn't mean the end of the universe as we know it. It just seems that way when there's a whole new row of icons when I open a Word document! What will Excel, which I've never really mastered, be like? How many files can I mess up? Definitely not in my comfort zone, it never occurred to me that I should take the IT person at her word when she told me this is a vast improvement over previous versions. Have I grown old and inflexible? Have I outlived my usefulness? Am I becoming as obsolete as Windows 98?

Wait a minute!!! Is this a pity party here? Am I frightened by a challenge? Office is, after all, just a software program...just another undiscovered intellectual domain to explore and conquer! Is there a point to my ramblings? Oh, yeah....not everything has changed. It's a small comfort that I still have the same telephone number and e-mail address, just a new fax number to memorize! 202-283-2392.

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