

# Low Income Housing Credit Newsletter

Internal Revenue Service

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*The LIHC newsletter provides a forum for networking and sharing information about IRC §42, the Low-Income Housing Credit and communicating technical knowledge and skills, guidance and assistance for developing LIHC issues. We are committed to the development of technical expertise among field personnel. Articles and ideas for future articles are welcome!! The contents of this newsletter should not be used or cited as authority for setting or sustaining a technical position.*

## Eligible Basis: Audit Strategy

The low-income housing credit amount is based on certain costs associated with a building qualifying as residential rental property; i.e., the cost of acquiring and rehabilitating, or constructing, a building. The total qualifying costs are known as the *eligible basis*.

Step 1: Determine that the costs are for depreciable assets on a building-by-building basis. And, since there can be more than one allocation (Form 8609), the costs should be associated with an allocation. Since some costs are incurred on a project basis, it will be necessary to determine how the taxpayer allocated the costs between buildings.

Step 2: Determine whether the cost is associated with residential rental housing, including the costs of personal property for use by the households, such as appliances. It can also include the cost of amenities such as garages, swimming pools and parking lots, as long as the taxpayer does not charge a separate fee charged for the use of the amenity and the amenity is available to all households. A portion of the cost of a community service facility can also be included.

Step 3: Determine whether costs were incurred before the end of the first year of the credit period. Eligible basis is the building's adjusted basis as of the close of the 1<sup>st</sup> taxable year of the credit period.

Step 4: Determine how the costs were financed. Ensure that the eligible basis has been reduced for any federal grants.

Step 5: Determine whether the cost is associated with the substantial rehabilitation of an existing building. These projects are subject to additional rules, which are addressed in Newsletter #17

Step 6: Once the correct eligible basis is determined, compare the result to the amount indicated by the taxpayer on Form 8609, Part II, line 7, which should be the same as on Form 8609-A, line 1.

The following information and documents are needed to audit this issue:

1. Form 8609, as completed/signed by both the state agency and the taxpayer.
2. Date each building in the project was placed in service. The taxpayer should provide certificates of occupancy. The information from the certificates should match the information on Form 8609, Part I.
3. Determine when the 10-year credit period started. It will be the tax year the building was placed in service, or the subsequent tax year if the taxpayer elected to postpone the beginning of the credit period on Form 8609, Part II, line 10a.
4. The taxpayer's depreciation schedules. Also ask for original construction contracts and receipts to verify cost amounts.
5. The taxpayer's credit application and final cost certification should be secured from the state agency, as well as the state agency's final gap analysis. These documents will include descriptions of the property, including amenities, which the taxpayer intends to construct. The cost certification should not be relied upon, but is a starting point for reconciling the taxpayer's documentation of eligible basis. The state agency's gap analysis will disclose the taxpayer's financing resources.

## **Proposed Regulation Update for Utility Allowance Released for Public Comment**

The IRS released proposed regulatory changes that would update Treas. Reg. 1.42-10, Utility Allowances. Most significantly, the proposed regulation provides for two new methods of computing a utility allowance:

1. An owner may obtain a utility estimate from the state agency that has jurisdiction over the building, provided the state agency agrees to provide the estimate. The estimate may be based on (1) the cost for units of similar size and construction located in the same geographical area, or (2) the actual utility company usage data and rates for the building.
2. The utility allowance can also be calculated using the HUD Utility Schedule Model, which is available on the Low-Income Housing Credits page at [www.huduser.org/datasets/lihtc.html](http://www.huduser.org/datasets/lihtc.html).

The proposed changes to the regulation were released for public comment in the Federal Register on June 19, 2007 (Volume 72, No.117). Comments are due by September 17<sup>th</sup> and a hearing is scheduled for October 9<sup>th</sup>, 2007.

## **Revenue Procedure 2007-54: Updated Relief Procedures**

The IRS has released updated guidance for LIHC properties and state agencies located in areas declared major disasters by the President. The new revenue procedure supersedes (replaces) Rev. Proc. 95-28. Highlights include:

1. The date for meeting the 10% basis requirement is extended 6 months after the date the owner would otherwise be required to meet the requirement.
2. For carryover allocations, if the disaster occurs within the two year construction period, the IRS will treat the owner as having satisfied the placed in service requirement if the building is in service no later than December 31<sup>st</sup> of the year following the two year period.

3. For buildings in the first year of the credit period, the state agency has two choices: (1) treat the allocation as returned credit or (2) toll the beginning of the credit period, but not longer than 24 months after the end of the calendar year in which the disaster occurred. No credit can be claimed during the restoration period for such first-year buildings.
4. Buildings beyond the first year of the credit period will not be subject to recapture or loss of credit if the qualified basis is restored within a reasonable time. The state agency will determine how much time the owner needs, but in no case will the time be more than 24 months after the close of calendar year in which the disaster occurred.
5. State agencies, without prior IRS authorization, may permit owners to provide temporary emergency housing relief to displaced low-income individuals for up to 4 months beyond the date of the President's major disaster declaration.

Instruction for reporting the status of LIHC buildings damaged by disasters qualifying for relief under this revenue procedure will be included with the instructions for Form 8610.

## **Notice 2007-66: Relief for LIHC Projects in Gulf Opportunity Zone**

For qualified low-income buildings located in the GO Zone and beyond the first year of the credit period, the IRS has extended the maximum time period considered reasonable under IRC §42(j)(4)(E) from 24 months to 48 months after the end of the 2005 calendar year. The actual time period is determined by the state agency on a building-by-building basis. To qualify, the owner must be engaged in the restoration of the buildings qualified basis, which means:

1. on-going physical repairs to the building,
2. having entered into binding, written contracts for the repair or restoration to be completed within the restoration period, or
3. active negotiation of contracts for the repair or restoration, including obtaining permits for construction.

If a building's qualified basis is restored within the period determined by the state agency, not to exceed 48 months, the building will not be subject to recapture and the building may continue to earn credit during that restoration period.

## Changing Faces: Departing

Angie Kaminski, long time manager of the LIHC Compliance Unit at the Philadelphia Campus, has accepted a new assignment as an analyst with the Planning and Analysis Staff at the campus.

Kent Rinehart, program analyst on SBSE's Examination Specialization and Technical Guidance staff, is also leaving for a new assignment with the Penalties staff. Kent has worked with the LIHC as a revenue agent, field coordinator, and then as an analyst.

Both Angie and Kent will be genuinely missed for their enthusiastic support of the LIHC program, but we wish them well in their new assignments (really).

## Changing Faces: Arriving

Steve Howard has joined the LIHC contingent as our Technical Guidance Coordinator in Appeals.

## LIHC Administrative Reminders

**Expanding Exam, Project/Tracking Code:** All LIHC cases should include Project Code 0670 and ERCS Tracking Code 9812. If the audit is expanded to include additional years or related taxpayers, the additional returns should also carry the LIHC project code and tracking code designation.

**Form 5344, Revenue Protection:** The Examination Closing Record, Form 5344, contains four blocks of information to account for adjustments that reduce a credit carryforward. Blocks 44 through 47 identify the type of credit and the extent of any adjustment made. See IRM 104.3.12.4.55 through 58 for details.

**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.

**TEFRA Requirements:** As LIHC property owners are almost always partnerships, and are likely to be subject to TEFRA procedural requirements, please remember document actions taken and decisions made by completing:

Form 12813, TEFRA Procedures  
Form 13814, TEFRA Linkage Package  
Checksheet  
Form 13828, Tax Matters Partner (TMP)  
Qualification Checksheet  
Form 13827, Tax Matters Partner (TMP)  
Designation Checksheet

## 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](mailto:Grace.F.Robertson@irs.gov).

## ♪ Grace Notes ♪

*I imagine that you are the captain of a navy ship on patrol when your ship is hit by a missile from an enemy ship and the missiles just keep on coming. In moments most of the crew is lying on the top deck, injured and dying, and the ship is severely damaged. The remaining uninjured crew can only do one thing at a time, so what should you do first? Take out the enemy ship with your superior missiles? Get the injured out of harm's way? Fix the hole in the ship? Retreat before you sink?*

*I suspect the few of us will ever command a Navy vessel in the middle of a battle. We will, however, spend our days doing "stuff"; tasks that just absolutely must be done, tasks requiring prioritization, tasks intended to serve a purpose. Unless you are the captain of the ship, it may be difficult to see the big picture and whether your assigned task actually contributes toward the goal.*

*For example, IRS examiners conduct audits of tax returns to determine whether a specific*

*taxpayer is compliant with the Internal Revenue Code. Most people will agree that the very risk of an audit, and the possible negative outcome, is sufficient motivation to stop most people (but not all) from participating in serious noncompliance. But have you every tried to measure or quantify the impact? Does an examiner, doing audit after audit, necessarily see that impact?*

*Similarly, state agencies are required to physically inspect LIHC properties and review tenant files at least once every three years. The very fact that LIHC properties are subject to review is an incentive for most owners to maintain the property in a manner suitable for occupancy and ensure tat the households occupying the units are income qualified. Findings of noncompliance have immediate consequences for the owner; the noncompliance is reported to the IRS, which may result in an IRS audit, and the taxpayer may be excluded from future allocations of credit for new projects. If you consider the ways the low-income housing industry is integrated with checks and balances, it is not difficult to see the most owners (but not all) are diligent in maintaining compliance and avoiding the consequences of noncompliance. But can we really measure or quantify the impact of the state agencies' reviews and inspections? Is that impact visible to the state agency employee sifting through tenant file after tenant file?*

*Like the captain of the navy ship, each of us must set priorities in order to accomplish the most important tasks assigned to us. Like members of the crew, we don't necessary see the big picture. When deciding which tasks are most important, we need to keep focused on our single objective: providing decent, safe, and secure affordable housing to individuals and families who are in need.*

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*Have you thought about the captain's dilemma? What would you do? If you discuss the question in a group, you'll find a variety of answers and justifications; something to think about when setting your own priorities.*