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!!

Touring LIHC Properties
What You See, Don't See, and Should See

By Kent Rinehart, Revenue Agent

IRM 4.2.3.3, Audit Techniques for Tours of Business Sites, provides an overview of touring business sites. This IRM was written after a quality improvement process analysis team discovered that an effective tour of business sites reduced examination cycle time. In addition to this, the team also identified other benefits when tours were conducted; examiners demonstrated a greater awareness of other critical aspects of their examination. By touring the LIHC property, an examiner will gain insight and a working knowledge to address tenant issues, land issues, qualified basis issues, and other LIHC issues for the taxpayer.

Prior to touring the site, contact the LIHC Compliance Unit at the Philadelphia Service Center (PSC) at (215) 516-7609 and inquire if any notices of noncompliance (Forms 8823) have been filed by the local state housing agency. Also ask if they have any other BINs for the same owner. You want to know if your taxpayer had any notices of noncompliance, whether the owner has other projects, and the extent of noncompliance reported on Form 8823 for these projects as well. If the Compliance Unit has something on file, they can either fax or mail it to you. *(Continued on page 2)*

Sometimes It Really Is Easy

By Janet Roxroth, Revenue Agent

I recently concluded an audit of a TEFRA partnership return with a low income housing tax credit. This return was classified because of a large difference between the basis of fixed assets on the balance sheet and the "qualified basis" shown on Schedule A of Form 8609 filed with the return. The taxpayer did not include the front page of the form.

The records maintained by the partnership and their accountants were excellent. Turns out the taxpayers were entitled to the 130% basis increase under IRC § 42(d)(5)(C)(i)(II). No adjustments were made to the credit amount.

This audit could have been avoided if a copy of the *entire* Form 8609 had been attached showing that the taxpayers were providing housing in a high cost area.

Assisted Living Facilities: Record Keeping Requirements and Optional Services

By Louann Denniss, Revenue Agent

A LIHC examination was initiated as a result of a referral from a state housing authority. The state's property review included a detailed inspection of 20% of the tenant files in an assisted living facility marketed to senior citizens. All of the files showed deficiencies, including:

- Failure to certify income, or failure to recertify income annually
- No leases, or leases for 60 days
- Using net, rather than gross, social security payments to compute annual income,
- Income apparently in excess of the limitation, and
- Rent charged in excess of the limitation [Reg. 1.42-5(c)].

The examiner's audit of the taxpayer's tax returns included a 100% review of the tenant files, going back to the first year of the credit period. The examiner found the same deficiencies the state had identified in more than 70% of the tenant files.

In addition, IDRS was used to determine the amount of income the tenants reported on their tax returns. None of the tenant files contained copies of tax returns, although the regulations mention tax returns as one way to verify income [Reg. 1.42-5(b)]. Several residents had income a few thousand more than the annual limit, and a few had more than double the allowable income.

The taxpayer originally claimed "applicable fractions" of nearly 100%. During the audit, the taxpayer provided revised figure, but could not provide the details of the computation; only how *many* units and how *much* square footage he used in his calculation. The specific units included in the computation could not be identified. As a result, it was not possible to compare the taxpayer's computation to the examiner's detailed analysis of the tenant files.

In addition to the record keeping deficiencies, it was also determined that the rent charged was in excess of the limitation because the services provided to the tenants were not optional [1.42-11(b)]. The brochures used for marketing the facility before the federal examination listed various services that were included in the rent. After the examination started, the brochures were changed to separately list the rent as an amount below the LIHC limit and the services as "optional". In these new brochures, the rent was listed at an amount equal to the maximum allowed by law, which also happens to be less than half of the rent that is charged to the tenants living in comparable units in a non-LIHC building that the taxpayer owns. The leases signed after the examination began are for 180 days rather than 60 days.

The taxpayer's position is that that tenants signed a services agreement stating that the services were optional, and that an applicant would not be turned down because they didn't need the services. The taxpayer also indicated that there had never been a resident who didn't avail themselves of the optional services. None of the files inspected contained the service agreement, except a few that had leases executed after the audit began.

Third parties contacts were made (using RRA'98 procedures) with some of the residents. Many of the tenants couldn't remember if they were told the services were optional, but most indicated that they were specifically seeking those services.

Eligible Basis Update: Land Cost

Last fall five Technical Advice Memoranda addressing the inclusion of certain land costs, including impact fees, in eligible basis were released. Here's the latest news-----

- The Service selected the inclusion of impact fees in eligible basis as one of seven issues to be addressed by the new pilot Industry Resolution Program (LMSB).
- Regulations for Section 42 are on Chief Counsel's 2001 work plan to be updated.
- Rep. Johnson may introduce legislation establishing a statutory definition of eligible basis.

…Touring LIHC Properties (continued)

An examiner can learn much simply by taking a drive-by tour of the LIHC project itself as well as evaluating the surrounding neighborhood. Some of the things to consider include:

What signage and advertising is associated with the LIHC property? Signs posted around the property and ads in local papers or yellow pages may give insight as to how the owner is trying to represent this property. Consider if there are any indications that the property is low-income, affordable housing or whether it is being presented as luxury or student housing.

What might the land have looked like prior to the development of the LIHC property? Try to envision the amount of land grading, clearing, grubbing, cutting, filling and rough grading costs the developer needed to get the land suitable to construction. Such costs are generally considered land costs.

What other non-household buildings are on the LIHC property? Garages, picnic areas, gazebos**,** laundry rooms, community rooms, and other buildings need to be considered when determining the qualified basis of the LIHC property. Also identify if the number of garages equal the number of rental units available. Eligible basis includes the cost of facilities for use by tenants to the extent there is no separate fee for their use and they are available to all tenants. It may also include the cost of amenities if the amenities are comparable to the cost of amenities in other units.

What do the buildings look like? Does the developer use wood, brick, stone, siding, or other material throughout the project? Is the building trim and other accents minimal or are there signs that much of the structure components and fixtures are upgraded? You can't judge a book by its cover, but it can give you an indication of whether or not the property is being represented as affordable or luxury.

Are the buildings and grounds well maintained and safe? Look at the buildings, windows, grounds, sidewalks, parking lot, dumpsters, common areas and landscaping to again get a sense of the owner's diligence in providing affordable housing.

What does the landscaping look like? How much landscaping is there? How well is the landscaping maintained? Is it trimmed? Is it overgrown or weedy? Is there a pond or lake on the property? If there is, consider if the taxpayer included these costs as qualified basis. This is not necessarily part of qualified basis. Rev. Rul. 74-265, 1974-1 C.B. 56, held that land preparation costs such as landscaping may be subject to a depreciation if such costs are so closely associated with a depreciable asset so that it is possible to determine an useful life. If the landscaping will be replaced contemporaneously with the related depreciable asset, or will require the physical destruction of the landscaping, this test will be considered satisfied.

What types of vehicles do the tenants drive? Much can also be learned by observing the assets of the tenants that live at the property. This is not an exact science, but the models and makes of cars will give you an indication of the tenants' income levels.

What is the economy like in the surrounding area? What businesses or employers are within close proximity? Is the immediate area considered white-collar, blue-collar, or other? Is the immediate area considered high-income, middle-income, or lower-income?

Are there any colleges, universities, or other educational institutions in close proximity? The student issue was, is, and always will be an issue to consider especially if such places are close to the taxpayer's LIHC project.

Is there a potential duplication or diversion of costs? If the owner has more than one project, remember to look at the internal controls to ensure all costs are properly attributable to the appropriate property. Try to ascertain (i.e., cost per square foot, or valuation of neighboring building, etc.) if the costs reflected on the return for the properties you toured match those reflected on the return. If the costs appear high on the return, carefully examine where the building materials were delivered.

Identify the similarities and differences between the projects. If an owner buys building materials and supplies in bulk, ensure that the appropriate materials (and appropriate amounts) were delivered and used at the intended site.

Also, if the owner is in relatively close proximity to the LIHC project, the owner should be considered a related party subject to the Required Filing Checks outlined in IRM 4.2.5.

What does the property look like on the inside? Also tour the structures on the LIHC property site. Keep in mind some of the points discussed above. Also, you will want to identify any common areas or non-rental areas that you may not have been aware of when you conducted your external tour.

Then, analyze what you saw, what you didn't see and what you expected to see. Does it make sense? Is what you saw consistent with the tax return and other supporting information available to you? If it doesn't make sense, chances are you will identify significant issues.

Finally, IRM 4.3.3.6(1) provides that "Examiners should document that a tour or inspection was completed and describe the results; including observations and resolution of any questions. The tour of the business site … should also be noted on the activity record." If a picture is worth a thousand words, then a tour of the business site is priceless. It is our right to tour the business site—it is our job to tour the business site—it is an invaluable tool to tour an LIHC business site.

Private Letter Rulings

LTR 200112051 - A partnership was granted an extension to elect to treat its residential rental property as qualified low income housing under IRC 42(g)(1). The taxpayers was required to file amended Forms 8609 for all open years, that included the intended election, within 45 days.

LTR 200107022 - A partnership was granted an extension to identify buildings as part of a multiple-building project under IRC 42(g)(3)(D). The taxpayer was required to file amended Forms 8609 for all open years to identify each of the buildings in the project.

Disclosing Tenant Information

Low income housing owners are required to determine whether potential tenants are income qualified using extensive verification procedures, including documentation with W-2's, check stubs and contacting employers. As part of an audit, examiners review the owner's procedures and records to confirm that tenants are qualified to occupy low income housing units; i.e., their income is less that the ceiling amount.

One simple and efficient audit technique we can use to verify that tenants are qualified is to identify all the returns with AGI's above the ceiling that were filed from the project's address. Then, examiners can review those tenant files.

Audits are considered tax administration proceedings subject to the disclosure provisions of IRC 6103(h)(4). This provision allows the disclosure of otherwise protected third party information under two specific conditions: (1) if the treatment of an item reflected on such return is directly related to the resolution of an issue in an examination (related parties), or (2) if there is a transactional relationship between the third party and the taxpayer which directly affects the resolution of an issue (landlord-tenant relationship).

Government Liaison and Disclosure (GLD) has advised us that IRC 6103(h)(4) does not force examiners to disclose information; it merely gives examiners the authority to disclose if any of the conditions are met. The discretionary ability provides examiners with leeway in terms of what needs to be disclosed to successfully complete the examination. It may not be necessary to disclose a tenant's specific AGI; simply that the tenant's AGI exceeds the ceiling. Certainly, the decision to disclose AGI amounts should be made on a case-by-case basis and with the involvement of management. If you need additional assistance, please call Michael Sincavage, of GLD, at 202-622-3406.

Who Do You Call?
The LIHC Compliance Unit

State agencies are responsible for monitoring LIHC properties for compliance with the requirements of Section 42; e.g., health and safety standards, rent ceilings and income limits, tenant qualification, and record keeping. State agencies perform desk audits, inspect housing, and review tenant files. When noncompliance is identified or there has been a property disposition, the state agencies notify the IRS using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition. Seventeen categories of noncompliance are included on the form.

The states send the forms to the Philadelphia Service Center, where the LIHC Compliance Unit processes the forms. They send notification letters, identifying the type of noncompliance reported on Form 8823, to taxpayers with instructions to contact the state agency to resolve the issue. Once the issue is resolved, a "back in compliance" Form 8823 is filed by the state.

As a revenue agent, you can get information about the state's filing of Forms 8823 for the property you are auditing. Here's a list of people to call about Form 8823 filings, based on the states they work with. Please limit your calls to LIHC issues.

Sam Aloi: (215) 516-7609 - Arkansas, District of Columbia, Hawaii, Montana, North Dakota, Rhode Island, Pennsylvania, Virgin Islands, Vermont

Delores Failla: (215) 516-2541 - Connecticut, Delaware, Michigan, Nevada, Ohio, South Dakota, Utah, Wyoming

Ann Grey: (213) 516-7613 - Alabama, Kansas, Kentucky, Missouri, New York, Washington, Wisconsin

Vito Trimarco: (215) 516-7668 - Alaska, Georgia, Idaho, Indiana, Maine, New Mexico, Texas, West Virginia

Marcy Morales: (215) 516-2202 - Florida, Iowa, Illinois, Massachusetts, Mississippi, Puerto Rico, Tennessee

Bonnie King: (215) 516-7621- Nebraska, New Hampshire, New Jersey, Oklahoma, Oregon, South Carolina, Virginia

Carol Orzechowicz: (215) 516-7147 - Arizona, California, Colorado, Louisiana, Maryland, Minnesota, North Carolina

Just a Reminder….

Please update LIHC cases to Project Code 670 and ERCS tracking code 9812. The project code may drop off in favor of the TEFRA project code, but the ERCS code will not be affected and will allow us to track the case.

♫ Grace Notes ♫

In Kent's article about touring LIHC properties, he referenced the findings of a process analysis team studying the span of examinations. I thought I'd follow up with more information about the project and their findings.

The former Pittsburgh District studied the examination process using the closed case database, ERCS, EQMS and process measures data. The team then identified numerous potential root causes of poor performance and13 potential solutions.

One solution addressed touring business sites during the audit of corporate returns. Analysis indicated that the average cycle time dropped significantly when the taxpayer's business site was toured. Further, Pittsburgh also found the touring the business site impacted the technical quality of the audit..

When the business site was toured, agents:

- *Identified significant issues more often;*
- *Conducted better interviews with the taxpayers;*
- *Completed better evaluations of the taxpayer's internal controls;*
- *Completed the minimum income probes more accurately;*
- *Satisfactorily analyzed the taxpayer's financial status more often;*
- *Effectively considered prior, subsequent and related return more often; and*
- *Selected the appropriate audit techniques to complete the audit more often.*

Not only did Pittsburgh identify these relationships, but so did other process analysis teams. National Office duplicated Pittsburgh's analysis and also validated their findings.

Knowing that tours of business sites positively influence cycle time and case quality, Pittsburgh worked with experienced examiners to develop guidelines for touring business sites. The guidelines were included in IRM 4.2

While there are many factors that will influence the timely completion of any case, it is clear that touring business sites helps examiners "do their homework" and prepare for conducting quality examinations in a timely manner.

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