

Low Income Housing Credit Newsletter

Internal Revenue Service

Issue No. 4

October 2001

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!!

LIHC and Rehab Credit Cases Designated as Mandatory Audits

By Grace Robertson

In a memorandum to SBSE Compliance Directors and LMSB Industry Directors dated September 19, 2001, LIHC and Rehabilitation Tax Credit cases were designated mandatory audits. The memo was signed by Sharon Oliver for Martha Sullivan, Deputy Director, Compliance Policy (SBSE) and Thomas J. Smith, Industry Director, Heavy Manufacturing and Transportation (LMSB).

The mandatory audit designation will ensure that cases are given priority. The designation, however, does not establish a compliance "project" requiring that a certain number of audits be completed. Audits will be identified on a case-by-case basis.

The LIHC program is co-administered with state housing agencies that monitor properties for compliance with the requirements of IRC 42. When they identify noncompliance, they notify the IRS using Form 8823.

New procedures have been implemented to timely and routinely identify egregious noncompliance based on the Forms 8823 reports filed by the state agencies responsible for monitoring compliance. It is anticipated that only a small number of cases will be sent to the field for audit and the returns will reflect egregious instances of noncompliance. Some examples include selling a property without reporting the sale or recapturing the credit, claiming the credit for five years without signed Forms 8609 from the state agency, and plumbing that is not connected to the sewer system so that waste backs up into the houses. Nonqualified households can easily put the minimum set-aside in jeopardy; i.e., full-time students or transient tenants.

Cases will be sent to the field if there are major violations of health, safety and building codes; the taxpayer has not met the minimum set-aside; or if the state agency has removed the property from the program. Cases will also be sent to the field if the taxpayer disposed of a LIHC credit without either posting a disposition bond (or Treasury security), or did not recapture the credit.

Case files will include a classification checksheet with an explanation and all available information, such as Forms 8823 and backup documentation and research findings from property records or other sources. Files will also include copies of prior, subsequent, or related returns as background information.

If needed, Headquarters will provide technical assistance. If you need assistance, please call Grace Robertson at 202-283-2516.

...And Just a Reminder....

LIHC cases should be updated 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.

Recapturing Accelerated Low Income Housing Credits

By Kent Rinehart, Revenue Agent

The recapture of any LIHC is done under the provisions of IRC 42(j). Recapture is required, at any time during the 15 year LIHC compliance period, when:

- There is a decrease to qualified basis, or
- There is a disposition of a low-income housing building, or

- There is a disposition of an interest in a partnership that owns a low-income building. The LIHC is really a 15-year credit. While the taxpayer is required to maintain the property as low income housing for 15 years (the compliance period), the credit is claimed in the first 10 years (the credit period). In effect, the last five (*of 15*) years of the credit are accelerated into the first 10 years of the compliance period. The accelerated credit equates to an acceleration rate of 1/3 (or 5/15) that may be recaptured if the taxpayer does not maintain the property as low income housing at any time during the compliance period.

Thus, if any of the above recapture provisions apply, the accelerated portion (or one-third) of the credit claimed in earlier years is recaptured for all prior years. However, recapture is made only to the extent that taxpayers receive an actual tax benefit.

On full dispositions or if the LIHC project falls below its elected minimum set-aside percentage, the accelerated portion of the credit is recaptured and no current year credit is allowed on any units. Where there is a partial disposition or any other decrease in the qualified basis of the project, the accelerated portion of the credit is recaptured and the current year credit is adjusted to the extent of the units that are not in compliance.

And, in addition to recapturing the credit, IRC 42(j)(2)(B) provides that interest must be calculated at the overpayment rate of IRC 6621 for each prior taxable period starting with due date for filing the return for each prior taxable year involved. The current ATG provides additional guidance in Chapter 7, Recapture of the Credit.

All adjustments for the amount of recapture and recapture interest can easily be reflected on examination reports.

Individual Returns

Using the RGSNT software, you will need to create a new issue titled “Recapture Section 42 LIHC.” However, no matter what you call it, this title will not appear on your examination report. The only wording that will appear on your report is “Other Taxes.”

In categorizing this new issue, it is recommended that you select the “Taxes” option in the first pop-

up menu. Then you will either need to select the “Additional Taxes” or the “Other Taxes” option two different times in the second and third pop-up menus that will appear. RGSNT has options for Recapture of Investment Tax Credit, Recapture of Education Credit, and Recapture of Federal Mortgage Subsidy, but does not have an option pertinent to recapturing LIHC.

To minimize any confusion, it is recommended that the heading in your explanation of items be entitled “Other Taxes – Recapture Section 42 LIHC.” The “Other Taxes” ties in with the Form 4549 you give the taxpayer and the “Recapture Section 42 LIHC” provides a short clarification of why such other taxes are being adjusted.

And, as you do for other issues, you will need to input the “per return” amount, “per exam” amount, the reason code and form/schedule. The UIL Code you will need when creating this issue on RGSNT is 42-10-00. Save this new issue and then proceed to the interest computation for your recapture amount.

To compute the proper amount of interest, identify each of the tax years of recapture and the amount of LIHC recapture *for which the taxpayer received benefit*. Next, identify the date through which you want interest computed. If the case is unagreed, compute the interest through 30 days after the report date. If the case is agreed, then check with taxpayer about date of payment. Then, have someone in Examination Support and Processing function (ESP) run the computations for you. Also, because of the intricacies of interest netting, offsets, and IRC 6404(g), it will be necessary to have ESP compute the interest on your total examination deficiency as well. Once you have these figures, the next step is to reflect this information on your report.

In doing the tax computation of your RGSNT report, do not check the “Include Interest” box on the tax computation screen. In essence, your report won’t show any interest, but you will be able to clarify this by going into the “Other Information Section” on the tax computation screen.

For the “Other Information” section, the following wording is recommended:

Interest on the above deficiencies includes the following to the extent shown per the computations enclosed with this report and summarized below:

IRC 6601 interest on examination tax year deficiencies \$?,???.??

IRC 42(j)(2)(B) interest on recapture of LIHC ?,???.??

Total interest for this report computed through (date) \$?,???.??

Interest will continue to accrue in accordance with IRC 6601. This interest computation has been computed in accordance with IRC 6404(g) relating to the suspension of interest after 18 months from the due date of the returns under examinations. Interest will continue to accrue until such time that all amounts owed are paid.

The computations for each category of interest will need to be enclosed with the examination report. When closing the case for processing, Form 3198, Special Handling Notice, should reflect your IRC 42(j)(2)(B) interest in the Special Instructions to ensure assessment of the proper amount of interest.

Business Returns

RGSNT software is not yet available to recapture LIHC on Partnership, S-Corporation or C-corporation returns. You will need to use RGS software for your examination report.

You will need to create a new issue through the “Enter/Modify Form 4318 Adjustment” option. At the new adjustment screen’s SAIN block, press the F4 button and select the Schedule K option from the pop-up menu. Scroll down to and select the appropriate SAIN number that categorizes your issue, from 912-02 through 912-05. At this point, you may accept the title that is in the issue block or enter one of your own. This does not appear on your examination report. Then enter the year and adjustments. In the categorize block, press D and

then scroll over to the “SEPARATE” top line heading (upper right of screen next to QUIT) and select it. You will then need to select option A or B (from the pop-up menu) depending on whether or not IRC 42(j)(5) applies to your case with respect to certain partnerships. This categorization will allow the proper wording to be shown on the examination reports for the LIHC recapture adjustment.

As with individual returns, the recapture interest under IRC 42(j)(2)(B) must be considered. If you have a taxable return (i.e., corporation), when you get to the Tax Computation screen, you will need to select the “Tax Computation Only” block. [NOTE: If you have other penalties to be assessed on your case, you will need to clarify this in the “Remarks” section of RGS as there is no way to include penalties on an examination report, but at the same time exclude the interest computation—unless you use white out!]. For non-taxable BMF returns (partnerships, S-corporations), interest does not appear on RGS examination reports.

However, for all BMF returns, interest for the recaptured LIHC as well as for current year deficiencies, will be determined in the same manner as shown above for individuals. To clarify the interest adjustments, it is recommended that you summarize all interest adjustments by selecting the “Remarks” block on the Print Examination Report screen and using the text shown above. Also, remember to note the case file Form 3198 accordingly to ensure that all interest will be properly assessed at the time of closing.

Overall, the potential for credit recapture issues is increasing as more and more projects reach the end of their 10-year credit period for claiming LIHC. The recapture adjustment is dollar for dollar of the accelerated portion claimed by the taxpayer. In addition, the recapture interest represents an additional adjustment apart from all other adjustments. Whether you utilize RGS or RGSNT, hopefully you will find that presenting these issues on your report will be easy.

Remember Utility Allowances?

Staff Reporter

At a time when energy costs are rising, a review of the utility allowance rules might be in order. The cost of any utilities paid directly by the tenant, other

than discretionary services such as telephone or cable, should be included in gross rent (IRC 42(g)(2)(B)). That is, the maximum rent that may be paid by the tenant is to be reduced by a utility allowance. The allowance can be determined in one of the following ways.

1. If a building receives assistance from FmHA, or tenants in the building receive FmHA housing assistance, then the FmHA utility allowance must be used.
2. Buildings that are both HUD regulated and FmHA assisted must use FmHA utility allowance.
3. HUD regulated buildings shall use HUD utility allowances.
4. Other buildings occupied by one or more tenants receiving HUD rental assistance payments must use the applicable public housing authority utility allowances established for the existing Section 8 housing program. Other rent restricted units in the building use the public housing authority allowance as well, unless a utility company estimate is obtained and then that estimate becomes the appropriate allowance *for the building* (except for the HUD assisted units which will continue to use the public housing authority allowance).
5. If none of the buildings or tenants are subject to the rules described in 1-4, then the public housing authority allowance is used. However, if an estimate is obtained for any unit from a utility company, that estimate is used as the utility allowance for all similar units in the building.

Allowances should be updated at the time rents are revised, but no less than annually, and shall be used to calculate gross rents paid 90 days after the date of occupancy. If a utility company estimate is used, the update should be within 90 days after the date of the utility company estimate.

If the unit's applicable utility allowance changes, the new allowance must be used to compute gross rents of rent-restricted units beginning 90 days after the change.

Examiners should make sure that utility allowances are updated in a timely manner and that rent limits are properly reduced by the amount of the utility allowance.

♪ Grace Notes ♪

On September 11th I stood at my office window and watched black smoke billow from the Pentagon across the infamous Washington Beltway. A few minutes later we knew that the World Trade Center was also in flames, and within an hour our building was evacuated. An hour later I was home, and with the rest of America, watched the tragedy unfold on television. And like many of you, I was asking myself who I knew that might be in immediate danger....and what I found out was that I was on many of your lists. It was with selfish relief that my friends were safe and profound gratitude that I responded to your messages.

In a sense, there is an IRS family and within the Low Income Housing Credit "industry" there is another "family" into which I have been warmly welcomed. Combined, I stand at the nexus of a community. Yes, property owners have a profit motive and revenue agents audit returns, but there is also an understanding that our purpose is to provide decent, affordable housing to individuals and families who are in need.

Thanks to the owners and property managers, who provide safe, clean housing and services with commitment - and thanks to those that help them. Thanks to the state agencies who administer their programs with compassion and diligence. Thanks to the National Council of State Housing Agencies, with whom we work so closely. Thanks to my IRS Management, who support me and a program that reaches beyond our usual paradigm of tax law administration. And thanks to the examiners who fairly, and with integrity, administer tax law. My thanks to all of you.

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