

# 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.

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## IRC §42(l)(1), First-Year Certification

Taxpayers owning IRC §42 housing are required to complete a "First-Year Certification" under IRC §42(l)(1). The certification is made to identify specific information needed for the administration of the program and document specific elections that will govern how the housing is operated. The certification is made by completing Part II of the Form 8609, Low-Income Housing Credit Allocation and Certification, with Part I executed by the state housing agency. The completed certification is submitted, one time, to the IRS.

While it isn't possible to discuss each line's entry in detail, here's the short list of glitches to watch out for when completing the form.

### Line 7: Eligible Basis

- The amount on line 7 should reflect any increase under IRC §42(d)(5)(B) for being in a high cost area or specific reconstruction zones such as the Gulf Opportunity Zone (Form 8609, line 3b).
- Generally, the amount on line 7 should equal the amount on Form 8609-A, line 1, filed with the tax return, unless (for one of a number of reasons) the Form 8609-A shows there has been a reduction in eligible basis after the end of the first year of the credit period.

### Line 8a: Original Qualified Basis

Enter the Qualified Basis as of the end of the first year of the credit period using the Applicable Fraction as of the end of the first year of the credit period. Do not use the Applicable Fraction computed using the special rule for the first year of the credit period under IRC §42(f)(2). Two brain-teasing "glitches" may occur later:

1. computing the credit allowable in year 11 under IRC §42(f)(2)(B), and

2. computing the credit for additions to qualified basis after the end of the first year of the credit period under IRC §42(f)(3), which is not subject to recapture. See IRC §42(j)(4)(C).

### Line 8b: Multi-Building Projects

If you elect to treat a building as part of a multiple building project, then a statement identifying all the buildings that are to be included in the "project" must be attached to the Form 8609. Refer to the instructions for Form 8609 for a list of information that must be included in the statement.

The most common failure is forgetting to submit the attachment when electing to include the building in a multiple building project, which will result in each building being treated as a separate project even if the box on Form 8609 is checked "yes." The most immediate concern will be whether the building met the minimum set-aside requirement under IRC §42(g)(1).

### Line 9a

Line 9a is an election related to federally subsidized buildings. The definition of "federally subsidized" is different, depending on when the building was placed in service; i.e., before July 31, 2008, or after July 30, 2008. Refer to the instructions for Form 8609 for complete explanation.

- If neither Line 6a nor Line 6d is checked by the state agency to identify credit allocations to federally subsidized buildings, and Line 4 is zero, then you may either (1) check neither box, or (2) check the "no" box. Either choice is acceptable.
- If Line 6a or Line 6d is checked, and/or Line 4 is greater than zero (depending on when the building was placed in service), then the building is federally subsidized and you must check either "yes" or "no."

### Line 9b

Line 9b is an election applicable when two conditions are met; i.e., (1) the building has both market rate units and low-income units, and (2) the quality standards of the market rate units are above the average quality standards of the low-income units in the building. See IRC §42(d)(3)(B).

If both conditions are met, you must check “yes” or “no.” Otherwise, you may check “no” or not check either box; either choice is acceptable.

#### Line 10 – Irrevocable Elections

Line 10 includes four irrevocable elections.

- 10a is the election to begin the credit period the first year after the year the building was placed in service. Make sure your choice is consistent with how you are claiming the credit on your tax return.
- 10b is the election to *not* treat a large partnership (with 35 or more partners) as the taxpayer subject to the recapture provisions under IR §42(j). A partnership with 35 or more partners will be treated as the taxpayer unless the taxpayer makes an affirmative election by checking the “yes” box. For partnerships with fewer than 35 partners, just don’t check the “yes” box.
- 10c is the minimum set-aside election, either 20-50 or 40-60. For New York City only, there is a 25-60 option. The most common misunderstanding is that the elected income limit applies to all the low-income units, not just the minimum number of units. For example, if you own a 100% low-income building and elect the 20-50 minimum set-aside, then the income limit used to determine whether a household is income qualified is 50% of the Area Median Gross Income for all the low-income units, not just the 20% minimum number of units.
- 10d is the deep rent skewed 15-40 election. This election does not replace the minimum set-aside election (10c). Every unit qualifying for the deep rent skewed election will also qualify for purposes of the minimum set-aside.

And remember, once these four elections are made, they are irrevocable.

#### Declaration

The First-Year Certification is signed under “penalties of perjury.”

- Signature
- Taxpayer Identification Number (TIN) – identify the TIN of the person signing the certification.
- Date – the date the certification is signed.
- Name (typed or printed) – since the signature is often not legible (but very artistic), please identify the person signing the certification and make sure it is readable.
- Tax Year – identify the first year of the credit period.

#### Submission and Reconciliation

The First-Year Certification is filed one time with the LIHC Compliance Unit located at the Philadelphia Service Center. The address is:

Department of the Treasury  
Internal Revenue Service Center  
Philadelphia, PA 19255-0549

Please include the entire zip code as the last four digits identify the LIHC Compliance Unit within a larger IRS facility.

The certification may be returned to you if the certification is incomplete or we have other questions about the submission. Please respond timely.

### **Auditing the Year of Disposition by Sale: Credit Recapture Under IRC §42(j)**

**Editor's Caution:** This article is limited to discussing possible audit issues when a taxpayer owning an IRC §42 project disposes of the project by sale and the taxpayer selling the project is a partnership.

Although a taxpayer claims the IRC §42 credit over a ten-year credit period, the taxpayer is required to provide low-income housing in compliance with IRC §42 for fifteen years (the compliance period). In effect, the taxpayer is claiming credit in advance of providing housing during the last five years after the credit period has ended. As a result, one-third of the credit claimed each year during the credit period is associated with providing housing during years 11 through 15 of the compliance period.

The one-third portion of the credit claimed each year is known as the “accelerated portion” of the credit or more commonly, it is referred to as the “accelerated credit.” If the taxpayer fails to operate the building in compliance with IRC §42 requirements, or disposes of the building, then the one-third accelerated portion of the credit claimed in prior years is subject to “recapture.”

#### Dispositions and Credit Recapture Relief

Generally, the disposition by sale of a low-income building is a credit recapture event. However, under IRC §42(j)(6), the credit recapture provisions are not applied under specific circumstances.

#### *Dispositions After July 30, 2008*

IRC §42(j)(6)(A), as amended by the Housing and Economic Recovery Act, provides that the credit recapture provisions are not applicable solely by reason of the disposition of a qualified low-income building (or interest therein) if it is reasonably expected that the building will continue to be operated as a qualified low-income building for the remainder of the building’s 15-year compliance period.

Instead, the taxpayer disposing of the low-income building (or interest therein) remains subject to the credit recapture provisions should there be any reduction in the building’s qualified basis resulting in the recapture of credit under IRC §42(j)(1) for the year of the disposition or any subsequent taxable year.

In addition, the taxpayer disposing of the low-income building (or interest therein) is required to notify the Secretary (IRS) if there is any reduction in qualified basis resulting in the application of the IRC §42(j) credit recapture provisions. The statutory period for the assessment of the credit recapture amount does not expire before the expiration of three years from the date the taxpayer notifies the IRS. Further, such credit recapture amount may be assessed notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

#### *Dispositions Before July 31, 2008*

If a taxpayer disposed of a low-income building (or interest therein) before the 2008 amendment, credit recapture could be avoided if two conditions were met:

1. Under former IRC §42(j)(6)(B), the taxpayer reasonably expected that the building would continue to be operated as a qualified low-income building for the remainder of the 15-year compliance period, and
2. Under former IRC §42(j)(6)(A), the taxpayer furnished the IRS with a disposition bond in an amount satisfactory to the Secretary and for the period required by the Secretary.

Bonds were posted with the IRS using Form 8693, Low-Income Housing Credit Disposition Bond, according to instructions provided in Rev. Proc. 90-60. As an alternative, taxpayers were allowed to provide Treasury securities as collateral instead of a bond. See Rev. Proc. 99-11. The bond or collateral remained in effect until 58 months after the end of the 15-year compliance period.

An owner who disposed of a low-income building (or interest therein) on or before July 30, 2008, and timely posted a bond (or collateral) may elect to be treated as if the disposition took place after July 30, 2008, which will result in the cancellation of the bond or return of the collateral funds. Instructions for making the election are included in Rev. Proc. 2008-60. (Note: even though it has been three years or so, taxpayers can still make the election.)

The IRS can “call a bond” to recapture credit if it is subsequently determined that the new owner did not continue to operate the building as a qualified low-income building for the remainder of the compliance period.

#### Computing the Recapture Amount

IRC §42(j)(2) defines the credit recapture amount as equal to the sum of:

1. the aggregate decrease in the credits allowed to the taxpayer under IRC §38 for all prior taxable years which would have resulted if the “accelerated portion of the credit” allowable under IRC §42 were not allowed for all prior taxable years with respect to the excess qualified basis described in IRC §42(j)(1), plus

2. interest at the overpayment rate established under IRC §6621 on the amount determined under (1) above for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved.

However, the credit associated with additions to qualified basis under IRC §42(f)(3) is not subject to recapture. (Note: this credit is accounted for on Form 8609-A, Annual Statement for Low-Income Housing Credit, lines 7-11.)

#### *Recapture Rates*

If the recapture event occurs during the first eleven years of the compliance period, then the entire one-third accelerated credit is recaptured.

The accelerated portion of the credit subject to recapture decreases during the last five years of the compliance period as the taxpayer provides the housing for which the taxpayer claimed the accelerated credit during the credit period. The recapture rate is:

- For year 12, 0.267 (or 4/15)
- For year 13, 0.200 (or 3/15)
- For year 14, 0.133 (or 2/15)
- For year 15, 0.067 (or 1/15)

Once computed, the credit recapture amount (credit plus interest) is an indivisible amount. No deduction is allowable for the interest described in (2) above for federal income tax purposes.

#### Reporting Recapture Events

The partnership should complete Form 8611, Recapture of Low-Income Housing Credit, to report the recapture event. A separate form is used for each building for which a computation of the credit to be recaptured is being computed.

The recaptured credit will be a partnership item passed through to the partners on the Schedule K-1, line 20 and identified using Code G, Recapture of Low-Income Housing Credit (other). The individual partners will then complete Form 8611 to apply the IRC §42(j)(4)(A) tax benefit rule to determine the exact recapture amount and possible reduction of any credit carried forward.

If the partnership is a large partnership under IRC §42(j)(5), with 35 or more partners, that did not elect *not* to be treated as the taxpayer, then the partnership is treated as the taxpayer to which the credit was allowed. The entire recapture amount is calculated at the partnership level and the tax benefit rule under IRC §42(j)(4)(a) is not applied.

#### Audit Issues

The issues discussed here are specific to partnership returns.

#### *Partnership Reported Recapture Event*

1. Was the credit recapture amount reported on Form 8611 correct? At the partnership level, the taxpayer is required to report only the accelerated portion of the

credit to be recaptured. This amount is entered on Form 8611, line 7. Only large partnerships with 35 or more partners are required to compute the interest portion of the recapture amount at the partnership level on line 16 of Form 8611. See IRC §42(j)(5).

2. Did the taxpayer correctly allocate the accelerated portion of the recapture amount among *all* the affected partners? For example, did the taxpayer include Schedules K-1 for former partners subject to the credit recapture provisions?

#### *Taxpayer Did Not Report Recapture Event*

1. Did the partnership have reason to expect that the building would continue to be operated as a qualified low-income building under IRC §42 for the remainder of the 15-year compliance period? The taxpayer will need to provide evidence that its expectation was reasonable. If not a reasonable expectation, the taxpayer is subject to the IRC §42(j) credit recapture provisions.
2. Is the building currently being operated in compliance with IRC §42 requirements? If not, then the taxpayer is subject to the IRC §42(j) credit recapture provisions. The building's current status can be confirmed by contacting the housing agency that made the credit allocation.

#### *Additional Issues*

In addition to considering the IRC §42 recapture issues, there are three additional issues to consider:

1. If the disposition occurs during the credit period, then the allowable credit is allocated between the seller and purchaser. See IRC §42(f)(4) and Rev. Rul. 91-38.
2. Did the taxpayer correctly report the gain or loss on the sale?
3. Since the taxpayer is probably a partnership and the IRC §42 project is probably the partnership's only business activity, the tax return is probably the partnership's final return. Did the taxpayer correctly report the dissolution of the partnership?

#### *Caveat*

As noted at the beginning of this article, the discussion here has been limited to the disposition of an IRC §42 project by a partnership (a "nontaxpaying" taxpayer). If the disposition is by a "taxpaying" entity, then additional rules apply and the special rules under IRC §42(j)(4) should be reviewed.

## Subscribing to the LIHC Newsletter

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

## Administrative Reminders

**Expanding Audits, Project/Tracking Code:** All IRC §42 cases should include Project Code 0670 and Tracking Code 9812. If the audit is expanded to include additional years or related taxpayers, the additional returns should also carry IRC §42 project code and tracking code designation.

**Surveying LIHC Tax Returns:** If you believe it is appropriate to survey an IRC §42 case, please fax Form 1900 to Grace Robertson, at 202-283-2485, for signature approval.

### ♪ Grace Notes ♪

I spent most of September wrapping up fiscal year 2011 and October will be focused on starting the "new" year off right. Beginnings and endings...or is that endings and beginnings...I'm never quite sure...but we measure (granularly and microscopically) and then quantify our success (or progress towards it), and then realize that (so Einstein demonstrated)...it was all relative anyway. But just when all the columns were reconciled, the reports were finalized, and the books were closed, those zippy little neutrinos were clocked going faster than nature's cosmic speed limit (as the theoretical physicists refer to the speed of light) and we've got to rethink the whole concept of "measuring" altogether.

So, while we await the final verdict regarding the reality of our success (and existence as a whole), which might take a year or two as the physicists triple check their speedometers, I pause to contemplate:

- As tumultuous as the past year has been, I hope there were at least one or two absolutely pleasant moments worth remembering now.
- I hope what you are doing right now is worth remembering tomorrow.
- I hope you have lots of tomorrows.

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