

# 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!!*

## **New Revenue Ruling: Impact Fees Includable In Eligible Basis**

*By Grace Robertson, Program Analyst for LIHC*

Recently issued Rev. Rul. 2002-9 provides guidance for including impact fees for determining the eligible basis. The revenue ruling was issued as the result of an Industry Issue Resolution Program project to address an issue that has been controversial within the LIHC industry in recent months.

### *What are Impact Fees?*

Impact fees are one-time charges imposed by a state or local government against new development or expansion of existing development to finance specific off-site capital improvements for general public use that are needed because of the new or expanded development. Taxpayers are required to pay impact fees to compensate the government entity for the financial impact of the taxpayer's development. The fees, for example, could be used to build a new school or expand a sewage system.

### *Findings*

As outlined in the revenue ruling, impact fees are indirect costs under IRC § 263A because they directly benefit, and are incurred by reason of, a taxpayer's production activity. Impact fees are assessed because of a taxpayer's plans to construct a new residential building. Thus, in accordance with Treas. Reg. 1.263A-1(f), the taxpayer must allocate the impact fees to the property produced. Because impact fees are calculated based upon the characteristics of the building and the impact fees are generally refundable if the building is not constructed as planned, the fees are 100% allocable to the building.

## **Reasonable Developer Fees**

*Kevin Woodward, Revenue Agent*

I recently concluded the audit of a TEFRA partnership return claiming the low income housing tax credit under IRC Section 42. One of the issues was the developer's fee. The taxpayer didn't have a developer agreement detailing the detailing the developer fee or any written description of the duties performed by the developer.

The Power of Attorney (POA) was able to provide a developer agreement currently used by the developer. The only written documentation for the developer fee was in the Partnership Agreement itself. The agreement stated the developer fee was "in order to compensate the General Partner for its construction-related activities".

The POA also provided a calculation taken from the Projected Cost Schedule showing the developer fee was 12% of the various cost categories. The state housing agency allows developer fees up to 15% of the various project costs as identified in the taxpayer's application package.

My primary concern about the developer's fee was the potential reallocation of a portion of the fee for the acquisition of the land. The taxpayer purchased the land for the apartment complex at fair market value from the developer, who was also the general partner. The taxpayer did not allocate any of the developer fee to the land acquisition activities.

Per the POA's oral testimony, the developer did not spend much time looking for land because he already had several parcels in his inventory for future development. An appraisal was done and the land was sold to the taxpayer at fair market value.

I verified the developer properly included the developer fee in income. The taxpayer's books and records were excellent and the taxpayer was able to substantiate all other amounts reviewed during the audit.

Based upon the facts and circumstances involved in this case, I concluded the amount of the developer fee included in eligible basis was reasonable. Although neither the taxpayer nor the POA could tell me how the dollar amount of the developer fee was arrived at and there was no documentation of the actual time spent by the developer doing "construction-related duties", the developer fee, in my opinion, was not inconsistent or excessive as compared to the total project costs. In addition, the taxpayer did not claim the maximum developer fee allowed by the state housing agency (15%).

As a result, I allowed the full amount of the Developer's Fee as claimed and included in eligible basis, primarily based on the reasonableness of the amount!

## **Real Estate Facilitator Training**

Examination Specialization has provided training for new facilitators in the Real Estate market segment, which includes the LIHC industry. The training was held in San Diego, January 29<sup>th</sup>-31<sup>st</sup>. The training included a two hour overview of IRC § 42 and the low income housing credit program.

The facilitators are working agents and will be able to assist examiners conducting audits of LIHC cases. For example, if the LIHC property is located in a state other than the location of the audit, the facilitator can complete the tour of the business site or contact a state agency for an agent.

The facilitators are Cheryl Blackwell, Frank Brand, Charles Coons, Brigitte Doan, Lois Dunn, Paul Gilbert, Karen Graham, Rita Hessman, Patrick Jolley, Cheryl Kiger, George Krmpotich, Carol Powers, Deborah Robinson, Barbara Seeds, Donald Senna, Paul Shields, Kimberly Slack-Richardson, Joan Steele, Ron Theissen, Peter Toporowski, Daniel Tran, and Mike Whalin. If you would like to contact one of the Real Estate facilitators, you can find their phone numbers in Outlook or send them an e-mail message.

## **LIHC Cases and Penalties**

*By Kent Rinehart, Revenue Agent*

If an examiner determines that an owner of LIHC property has been noncompliant, the next issue is to address the culpability of all parties involved. Culpability is identifying who is responsible for each noncompliant action and the extent of that responsibility.

Generally, a LIHC taxpayer is a partnership with 1% of the tax attributes assigned to a general partner and 99% assigned to limited partners. The general partner, however, is the tax matters person and quite often is responsible for the actual operation of the property. As the tax matters partner, the general partner will also represent the partnership during an audit. Examiners are familiar with IRC § 6662, accuracy related penalties, and IRC § 6663, the fraud penalty. However, these penalties are a percentage of the tax deficiency and are applicable to all partners. So, even though the examiner may determine that the general partner is culpable, these two penalties will be applied to all partners and only have a de minimis impact on the general partner.

But, if either of these penalties is warranted, they should be fully developed and assessed. If the limited partners do not agree with the assessment of penalties, the issue can be addressed through the Appeals process or they can take action against the general partner to recover any amounts they deem appropriate.

One Code section does allow examiners to directly penalize any culpable party for actions that result in an understatement of income tax. IRC § 6701, Penalties for Aiding and Abetting Understatement of Tax Liability, provides a penalty for any person who:

- 1) aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim or other document,
- 2) knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and

- 3) knows that such portion (if so used) would result in an understatement of the liability for tax of another person.

Overall, these provisions could apply to far more people than just the taxpayers involved. This section can apply separately to any individuals, general or limited partners, accountants, consultants, syndicators, property managers, management companies and anyone else that contributes to the on-going compliance of a LIHC project.

People who are culpable don't need to have a tax liability before a penalty can be assessed. The penalty under IRC § 6701 is applied on a per occurrence basis. For a corporation, the penalty is \$10,000 per occurrence. For all others, the penalty is \$1,000 per occurrence.

For each person that warrants such a penalty, the examiner will need to initiate a separate penalty case file, apart from the ongoing income tax examination. Please refer to IRM 4.10.6 and IRM 20.1.6.6 for details.

As a practical example, imagine that a partnership that has 15 partners. Any wrongful understatement of tax will impact at least 15 Forms 1065, Schedules K-1. If someone is culpable under the provisions of IRC § 6701, the penalty equates to \$15,000 (15 erroneous Schedules K-1 multiplied by \$1,000). Now, imagine that three different people were responsible for actions that caused an understatement on the same partnership return—the penalty under IRC § 6701 just increased to \$45,000 (3 x \$15,000). The only difference here is that you will have three different penalty case files—one for each culpable person.

LIHC examiners need to consider IRC § 6701 during the course of any examination where deliberate noncompliance can be attributable to a particular person. Often, it will be the general partner that bears the burdens of property management and tax responsibility. So, even though only a small percentage of the accuracy-related or fraud penalties may flow through to a partner, culpable parties should be aware that they could also be liable for additional penalties under the provisions of IRC § 6701.

And, when applying aiding and abetting penalties, examiner should consider whether harsher penalties

are warranted against the culpable individuals and entities. The harshest penalty would be for someone to cease and desist their actions with respect to the LIHC activity. For this, the IRS needs an injunction against such individuals and entities. The Code includes three sections that allow examiners to request injunctions:

- IRC § 7402 – Jurisdiction of District Courts
- IRC § 7407 – Action to Enjoin Income Tax Return Preparers
- IRC § 7408 – Action to Enjoin Promoters of Abusive Tax Shelters, etc.

Enjoining is an order by the court to stop something – in this case it could be as limited as to stop selling promotions or preparing certain tax returns or as broad as to never prepare a returns again or to shut down a web site. If the court order is ignored, the promoter would be charged with violation of a court order and the penalties could include prison.

Contact issue specialist Jim South at (419) 522-2455 and visit <http://abusiveshelter.web.irs.gov/> for more information about injunction actions, if you believe an injunction is warranted.

## PLR's and Cases

PLR 200206037 A partnership's transfer of its title for LIHC housing project to its general partner will not result in recapture under IRC § 42(j). The project was subject to real estate taxes under state law. However, under state law, if the title should be transferred to the general partner, the property would not be subject to the taxes. The partnership intends to transfer record title in the project and then lease the project back from the general partner. The partnership would retain all the benefits and burdens of ownership. The Service concluded that the transfer of bare legal title does not constitute a disposition or change in ownership that would result in credit recapture under IRC § 42(j).

PLR 200147008, 200147009, 200147010, and 200147011 The redemption of tax-exempt bonds after a low income housing development is placed in service will not result in a determination that the project was *not* financed with tax-exempt bonds under IRC § 42(h)(4)(B).

## Revising the Audit Technique Guide

We're in the process of revising the LIHC audit technique guide for recent changes in the law and new issues. Suggestions for topics, or if you would like to contribute material, please contact Grace Robertson at (202) 283-2516.

## Reducing LIHC Carryforwards & Getting Credit For It On Form 5344

Did you know that the Examination Closing Record, Form 5344, contains four important blocks of information that allow examiners to account for adjustments that reduce a credit carryforward?

Blocks 44 through 47, on Form 5344, identify the type of credit and the extent of any adjustment made. See IRM 104.3.12.4.55 through 58 for details.

So, even though you may have an LIHC case with no immediate tax potential and a large LIHC carryforward, Form 5344 allows you to identify the extent of any adjustment to the carryforward. As a result, you get the credit you deserve—once you do the paperwork!

### ...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.

## ♪ Grace Notes ♪

*As I work with the LIHC program, I often find myself explaining how we co-administrated the program with the state housing agencies. I thought I'd take a moment to explain the integral role the state agencies have in the success of this program*

*First, the agencies are responsible for determining the housing needs within their respective states. For example, they consider the needs of rural, suburban and urban areas, areas enjoying economic booms and communities suffering from depressed economies. They also consider the types of housing needed; e.g., housing for seniors, assisted living centers, single-family homes, apartments, or*

*transitional housing. From all the information they gather, they develop a "Qualified Allocation Plan" or QAP to define their priorities.*

*The state agencies are also responsible for allocating low income housing credits to taxpayers. Each year the states receive a specific dollar amount of credit from the federal government based on their population. Credits are awarded to projects based on applications or bids presented by developers. The process is highly competitive and each application is scored (given points) according to their ability to meet the priorities in the QAP.*

*Once a developer receives a credit allocation, they complete their project. The state conducts a physical inspection of the property to ensure it is built as promised and a final review of the taxpayer's costs to make the final determination of how much credit is needed to support the project. The final approval is documented on Form 8609, which the states submit 8609 to the IRS, so that we know the projects are approved and authorized to take the credit.*

*Finally, the states are also responsible for ensuring that the properties remain in compliance throughout the 15-year compliance period. At least once every three years, the state performs a physical inspection of the property to confirm that the owner is providing safe and secure housing. The tenant files are also reviewed to ensure that the tenants are qualified and that the rents are properly restricted. When they identify noncompliance, they report it to the IRS on Form 8823, which lists categories of errors. The forms are submitted to the Philadelphia Service Center and are the basis for classifying returns for audit.*

*This is just a simple overview of the states' areas of responsibility, but their work is at the very heart of the program. I hope this gives you a better idea what they do. This is a complex program with many stakeholders playing important roles to ensure ongoing success in providing affordable housing for those in need.*

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