Low Income Housing Credit Newsletter

Internal Revenue Service

Issue No. 6 ***June 2002***

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!!

Technical Issue: Claiming the LIHC Without Completing the Certification

By Grace Robertson, Program Analyst for LIHC

As part of our classification efforts, we have identified returns where the taxpayer is claiming the low-income housing credit, but for which the taxpayer has not yet received the signed Form 8609, Low-Income Housing Credit Allocation Certification, from the state agency. The form documents the state's approval of the finished project.

Generally, the taxpayer will complete Part II of the form to make the required elections for the first year of the compliance period. Part I, which is completed by the state agency, is left blank. The returns often include explanations that the Forms 8609 were self-prepared pending final approval of the project by the state agency.

Under IRC 42(l), a taxpayer must certify with respect to the first year of the credit period that:

1. the taxable year and calendar year in which qualified low income buildings were placed in service,
2. the adjusted basis and eligible basis of such buildings as of the close of the first year of the credit period,
3. the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under subsection (h),
4. the election made under subsection (g) with respect to the qualified low income housing project of which such building is a part, and
5. other information as the Secretary may require.

How Certifications are Made

The certification is made to the Secretary of the Treasury and must be made following the close of the first taxable year in the credit period for any qualified low income housing building. Unless it is shown that failure to certify the first year of the credit period is due to reasonable cause and not to willful neglect, no credit will be allowed with respect to such building for *any* year before such certification is made.

Treas. Reg. 1.42-1T(d)(8)(ii) states that housing credit allocations are deemed made when Part I of IRS Form 8609, Low Income Housing Credit Allocation Certification, is completed and signed by an authorized official of the housing credit agency and mailed to the owner of the qualified low-income building. The allocation must be made on Form 8609. Taxpayers are required to complete Part II of the Form 8609, Low Income Housing Credit Allocation Certification, on which a housing credit agency made the applicable housing credit allocation, and submit a copy of the form with their federal tax returns for each year of the 15-year compliance period. (Treas. Reg. 1.42-1T(e)(1).)

Carryover Allocations

Pursuant to IRC 42(h)(1)(E) or 42(h)(1)(F), a housing agency may make, in advance of a building's being placed in service, an allocation of housing credits. These "carryover allocations" are made with respect to qualified buildings, which will be placed in service no later than the close of the second calendar year following the calendar year in which the allocation is made. Carryover allocations alone do not constitute the certifications required by IRC 42(l). Taxpayers must file the Form 8609 (that was issued to them by the state housing authority after the building was placed in service) throughout the 15-year compliance period. (In the first year of the credit period, the taxpayer must file the carryover allocation document along with Form 8609 [See Treas. Reg. § 1.42-6(d)(4)].)

Window of Opportunity

Under IRC 42, owners cannot request Form 8609 from the state agency until the property is placed in service and cannot claim the LIHC until the state agency sends them the form with Part I completed and signed. For most taxpayers, this creates a window of opportunity of about four months between January (after the close of the first credit year) and April (when their tax return is due) in which to apply for and receive the completed Form 8609 from the state agency.

However, it takes about 9 ½ months (on average) after placing the property in service, to get the project approved by the state agency. (The time period is about the same for all the state housing agencies.)

And thus the taxpayer's dilemma: (a) file the tax return timely without the signed Form 8609 or (b) request an extension and file the tax return later when the state sends the signed form. Most property owners are partnerships, and they almost always choose to file the return timely and distribute their K-1's to investors, even though they do not have the signed Form 8609 in hand.

Audit Issue

Generally, the cases sent to the field involve taxpayers who are filing returns without completed Forms 8609 attached to the returns and the failure to certify the first year of the credit period is *not* due to reasonable cause. In these cases, examiners have several options.

First, there is no prohibition against satisfying the certification requirements during the examination process. Our purpose is not to remove otherwise compliant taxpayers from the program simply because the taxpayer was unable to complete the certification process timely. The taxpayer should be given the opportunity to provide completed Forms 8609 (signed by the state) during the examination. This action is particularly appropriate when the taxpayer submitted documentation to the state in a timely manner and encountered difficulties.

- Verify that the eligible basis includes only costs incurred before the end of the first year of the credit period, and
- Ensure that the applicable fraction for the first year reflects the first-year lease up and that the minimum set-aside was met.

Second, if the failure to complete the certification process is due to willful neglect, the entire credit should be disallowed, and appropriate penalties applied, for all years open by statute until the requirement is met.

If it is anticipated that the taxpayer may eventually be able to complete the certification, then

- the taxpayer should be cautioned that statutes should be extended (or claims for refunds filed) to ensure that the taxpayer can claim the credits at a later date.
- the examination should include verification of eligible basis, applicable fraction, and minimum set-aside for the first year of the credit period as part of the audit.

Finally, there will be cases when the taxpayer will never receive the Form 8609 from the state and will never be able to claim the credit. Under certain circumstances, state agencies can reclaim previously allocated credits within 180 days following the close of the first tax year of the credit period.

Credits may be returned because a building is not placed in service within the required period, failed to meet the minimum set-aside requirements by the close of the first year of the credit period; was not in compliance with the terms of the allocation as agreed to by the state housing agency and the credit recipient in the allocation document; the allocation was cancelled by mutual consent; or if the amount of allocated credit was not necessary for the financial feasibility of the project. (See Treas. Reg. 1.42-14(d)(2)(iv).)

In these cases, based on the state's determination, the property should be removed from the program and the appropriate penalties applied.

Back to Basics: Planning the Audit of a Low-Income Housing Project

By Kent Rinehart, LMSB Revenue Agent

The Internal Revenue Code (IRC), regulations and other provisions that explain IRC §42 may seem cumbersome when preparing an audit plan. To keep each audit plan simple, examiners will need to address four basic issues:

- Rent restrictions
- Tenant eligibility
- Physical condition of the property
- Computation of Eligible and Qualified Basis

Addressing these issues requires the compilation of a significant amount of information from different sources. The following outline provides a basic plan to help organize the process.

Information from the LIHC Compliance Unit

- Secure all Forms 8823 for the return (LIHC project) under examination, which will identify noncompliance issues discovered by the state agencies during their inspections.
- Secure all Forms 8609 for the return under examination.
- Secure information about bonds posted by prior owners when they sold the property or their interest in the property.

Information from the State Housing Agency

- Review the administrative file including owner's application for the credit.
- Review the compliance monitoring file maintained by the state housing agency.
- Determine whether the owner has additional projects within the state.

Examine Rental Income

- Reconcile the books to the return.
- Ensure that rent does not exceed the allowable rent ceiling.
- Ensure maximum rent corresponds to the proper maximum rent level based on the number of bedrooms for each respective unit.
- Identify any government rent assistance payments made on behalf of tenants.
- Ensure that the owner is properly computing and accounting for utility allowances and other amenities.
- Identify any other payments that could be categorized as rent, or should be separately stated, such as payments for assisted living support.
- Identify how cash payments are handled.

Examine the Tenant Files

- Tour the property. Observe the general standard of living, such as age and value of cars, etc.
- Review initial year tenant files to verify the applicable fraction.
- Review tenant files in year(s) under examination; compare to the first year.
- Ensure that any students are properly accounted for, especially if the project is in a desirable location for students.
- Ensure that the number of tenants is reasonable compared to the number of bedrooms in the unit.
- Ensure that the tenant(s) can afford to live in the unit based on the information they provided on the application.
- Ensure that the owner secures all necessary application information from all adult tenants.
- Ensure that the owner solicits and accounts for non-taxable income and assets of the tenants.
- Research all IDRS sources.
- Determine if there is a pattern or frequency of income items that the owner is not considering or not considering properly.

Examine Eligible and Qualified Basis of the Project

- Tour the project. Note all structures, landscaping and all other depreciable assets.
- Note how well the property is maintained (both inside and out).
- Tour the immediate surrounding area to get an idea of any schools, businesses and other economic information about the socio-economics of the area.
- Reconcile the assets observed to the costs included in eligible basis and reflected on the tax return.
- Ensure that the taxpayer has properly allocated costs to land, land improvements and depreciable assets.

- Determine if any of these costs are for credit syndication fees or other soft cost.
- Determine to what extent costs qualify for the credit.
- Identify how many low-income projects the owner has within the state (and any adjacent state, if feasible). For multiple projects, match costs to each project and ensure that costs have not been duplicated.

With this information, the examiner will be off to a good understanding of the facts and circumstances of the LIHC project their assigned. For each examination, the plan is simply to start with what the IRS and the state knows—and then compare that to the taxpayer's books and records.

LIHC Compliance Unit Contacts

As a revenue agent, you can get information about the state's filing of Forms 8823, reports of noncompliance, 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.

Manager: Angie Kaminski (215) 516-4113

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

Sharon Digiulio: (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

New Project Code for Rehabilitation Tax Credit Cases (IRC §47)

Project Code 082 has been assigned to the Rehabilitation Tax Credit program. Rehab Credit cases are also mandatory audits and a new code was needed in order to track cases through the examination process. Up to now, both Rehab and LIHC cases were assigned to Project Code 670.

…And Just a Reminder (Again)….

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♫

Over the last year, we have identified a limited number of taxpayers who have continued to claim the LIHC without have Forms 8609 signed by the appropriate state agency. While the issue is not common, we wanted to make sure you (examiners) have the information you need to develop and support the issue. Hopefully, the lead article will be helpful. If you have questions, please just give me a call.

You've also probably noticed that Kent Rinehart has been a regular contributor to the Newsletter. Kent is a LMSB Revenue Agent with a great deal of experience in the LIHC market segment and his Management has made him available to assist us with this program. If you need help with a case, you can reach him at 715-836-8751.

We'd also like to encourage you to write articles for the newsletters – share the issues you've found in your cases.

Have a great summer!

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