Low Income Housing Credit Newsletter

Internal Revenue Service

Issue No. 7 ***August 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!!

Head's Up: Treatment of State-Based Low Income Housing Credits

By Don Modglin, Revenue Agent

The state of Missouri offers several tax incentives, a number of which concern the issuance of transferable tax credits. In addition to receiving a federal IRC §42 LIHC on a qualified affordable housing project, Missouri offers it's own state Low Income Housing Tax Credit. The Missouri credit totals 40% of the federal tax credit. Generally, the Missouri state credit has no value to anyone other than someone with a Missouri income tax liability.

As a result, a partnership will be formed; one of the limited partners will be a nationally syndicated group of investors and another limited partner will be a Missouri limited partner who is a syndicator of the Missouri credit. The Missouri limited partner has no profit or loss interest and only the minimum capital interest required under Missouri law of .01 percent (.0001). Even though documents provided by the partnership document how the capital contribution was calculated, all of them speak of "buying" and "selling" the credits based on the present value of the total credits to be issued by the state of Missouri. The payment to the partnership for the Missouri credit is treated as a capital contribution to the partnership rather than a sale.

So is this the correct treatment? This isn't any guidance on point for Missouri's housing credit. But Chief Counsel, in Field Advisory 200211042 (issued February 5, 2002), did offer guidance for another Missouri tax credit known as a "remediation" credit for cleaning up hazardous substance contamination. Chief Counsel determined that the tax consequences when a taxpayer sells the state tax credit to **a third party** is a gain equal to the amount realized; i.e., since the taxpayer paid nothing for the credit, the taxpayer has no "tax cost basis".

The issue to be determined is whether a partnership's transfer of state-based housing tax credits to a limited partner with .01 percent interest is really a "sale" resulting in ordinary income or a reduction of the **limited partner's** basis (capital contribution).

Posting Surety Bonds to Avoid Low-Income Housing Credit Recapture:

By Sam Aloi, Revenue Agent

Section 42(j)(6) provides that a taxpayer that disposes of a qualified low-income building, or an interest therein, may defer or avoid recapture by furnishing a bond to the IRS in an amount satisfactory to, and for the period required by, the Secretary. The only condition is that it must be 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.

The minimum required bond amount is the product of:

(1) the total credits that the taxpayer has claimed, as well as any additional credits the taxpayer anticipates claiming (carry-forwards);

(2) the appropriate bond factor pertaining to the month in the compliance period during which the disposition occurred and the first year of the building's credit period: and

(3) the percentage of the taxpayer's total interest in the qualified low-income building disposed.

Guidance on the amount of the bond considered satisfactory by the Secretary and the period of the bond required by the Secretary under Section 42(j)(1) is provided in Revenue Ruling 90-60, 1990-2 C.B.3. The original bond amount may be increased, if necessary, with a strengthening bond. Replacement of the surety may be accomplished with a supplementary bond.

The bond must in place before the taxpayer submits the Form 8693. While IRC 42 and Rev. Rul. 90-60 are silent as to the submission date, the F8693 requests submission within 60 days after disposition of the property (or interest therein). Limited extensions may be approved based upon consideration of the facts and circumstances detailed in a written request to the IRS.

The term of the bond is equal to the remainder of the 15-year compliance period plus an additional 58 months.

The surety must be an approved company listed in the Financial Management Service/Department of the Treasury Circular 570. The bond number provided by the surety should be entered on the F8693 for identification.

The Form 8693 Worksheet for Computing Bond Amount should be accompanied by sufficient documentation to support the computation presented. The Building Identification Numbers (BIN), property addresses, and tax identification numbers of all participating entities will permit: (1) verification of the property to a valid Form 8609, Low Income Housing Credit Allocation Certification, that is approved by the state housing credit agency and (2) ensure future compliance. While not required, including the name and phone/fax number of an informed contact party reduces the processing delays due to computational /documentation inconsistencies.

If the Disposition Bond is accepted by the IRS, an approved copy of the Form 8693 will be sent to the principal as identified in Part 1 of the Form 8693. Compliance monitoring on the property will continue and reports of noncompliance may result in "calling the bond".

If the Disposition Bond is not approved, the owner must recapture the credit using Form 8611, Recapture of Low Income Housing Credit.

References: IRC §42(j), Rev. Rul. 90-60, TNT 180-62, and Form 8693, Low-Income Housing Credit Disposition Bond.

(Editor's Notes: Sam Aloi is the Revenue Agent for the Philadelphia LIHC Compliance Unit. He has been in civil service since 1980 with the Economic Development Administration and the IRS. He holds advanced degrees in Accounting, Management and Finance from La Salle University, St. Joseph's University and the Wharton School at the University of Pennsylvania. He can be reached at 215-516-7609, Fax: 215-516-2572/6071 or email: Samuel.MM.Aloi@irs.gov.)

…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.

Interviewing Taxpayers & Others

By Kent Rinehart, Revenue Agent

IRM 4.10.3.2 provides examiners brief insights as to what an interview entails. For Low-Income Housing Credit (LIHC) cases, here are five "W's" that will guide you through the interview process.

Who Should Be Interviewed

The **Philadelphia LIHC Compliance Unit**, which is an IRS source and is not considered a third-party contact. They are the examiner's resource to obtain the following:

- Forms 8823, Low-Income Housing Credit Agencies Report of Noncompliance,
- Forms 8609, Low-Income Housing Credit Allocation Certification,
- Form 8693, Low-Income Housing Credit Disposition Bond, posted by taxpayers disposing of their LIHC property or interest therein, and
- Recertification Waivers under Rev. Proc. 94-64, which waives the required annual certification of income qualifications if low-income tenants occupy 100% of the units.

The **State Housing Agency** (SHA), which is a third-party contact. You need to ensure that proper notice has been given the taxpayer prior to contacting the SHA. The state housing agencies report noncompliance issues to the IRS on Form 8823. They have administrative files that are open to the public. They also have compliance files that are available to examiners which document exactly why the Forms 8823 were issued to the taxpayer. (Note: the amount and type of information SHA's share with examiners differs across the country.)

Note: Be aware that the owner of the LIHC property under audit may also own other LIHC properties. Therefore, when talking to the LIHC Compliance Unit and SHA, it is important to inquire as to whether or not there additional LIHC projects owned by the same taxpayer.

The **Owner**. If the owner is determined to be an active, "hands-on" individual that is involved in many aspects of the LIHC property, they are the best source of information. However, some owners are distant operators who rely on management companies and property managers to conduct the day-to-day business operations.

Note: please remember that, under IRC §7521(c), a taxpayer cannot be required to accompany an authorized representative to an examination interview without an administrative summons. However, the taxpayer's voluntary presence at the interview can be requested through the representative as a means to expedite the examination process. (See IRM 4.10.3.2.1)

The **Property Manager or Management Company,** if a management company is involved. It is recommended that you interview both the management company, as well as each of the respective property managers. This enables you to determine the extent of internal control at all levels of the operation and ensure that both the property manager and management company are giving you consistent and accurate information.

What to Ask

IRM 4.10.6.3.1(1) states: "Questions asked during the initial interview with the taxpayer and/or representative should provide the examiner with an understanding of the taxpayer's background and knowledge, familiarity with the business operations, and an overview of the taxpayer's books and records. It is also appropriate to ask the taxpayer if they are aware of any errors on the return and discuss any issues identified during the pre-audit analysis." Interviews are important because oral testimony can provide information not otherwise available and establish the taxpayer's intent and due diligence. (See IRM 4.10.4.2) This is your opportunity to:

- Assess the owner's and manager's overall knowledge of the LIHC property,
- Assess the owner's and manager's knowledge of IRC §42 and compliance requirements,
- Determine what the owner has done in response to Forms 8823 issued in the past by the state housing agency,
- Identify all books and records maintained by the owner and property manager,
- Identify how tenants' initial applications are solicited and screened,
- Identify all actions taken to verify application information,
- Identify how income recertifications are done, and
- Assess internal controls within the entity.

Where Interviews Should Be Conducted

IRM 4.10.3.2.2 states that the Secretary will set the time and place of interviews, as long as the interview is reasonably scheduled. IRM 4.10.2.7.6, Place of Examination, states that (generally), examinations should be conducted at the location where the original books, records, and source documents are maintained. Also, under Treas. Reg. §301.7605-1(d)(3)(iii), examiners have the right to tour the taxpayer's business to establish facts that can only be ascertained by a direct visit, regardless of where the examination takes place (See IRM 4.10.3.3.1). In short, conduct the interview anywhere that is reasonable and conducive to business.

When Interviews Should Be Conducted

In order to avoid subjecting taxpayers to repeated interviews, it is recommended that you defer the initial interview with the owner and property manager until after you gather all available information from the LIHC Compliance Unit and state housing agency. With this information, you should be able to better understand the type of LIHC project you are auditing.

Then, before conducting the interview, you should review all available books and records presented by the taxpayer in response to their initial Information Document Request (IDR). By doing this, you should be able to identify any inconsistencies between the IRS, state housing agency, and the books and records that should be discussed with the taxpayer or property manager.

Why Are Interviews A Good Audit Technique?

Because an effective interview is an excellent audit tool that will expedite any LIHC examination.

Contacting State Housing Agencies: Third Party Contact Notification

By Grace Robertson, Program Analyst

Under IRC §42, state housing agencies are responsible for allocating low-income housing credits, monitoring LIHC properties, and issuing notices of noncompliance to the IRS. As a result, the state agencies maintain complete property histories, beginning with the taxpayer's submission to receive a credit allocation, and are the best source for information (other than the taxpayer) about the property.

IRC § 7602(c) requires the IRS to provide advance notice to the taxpayer when contacts may be made with third parties (see IRM 4.10.1.6.12 for more details). Most likely, contacts with the state agencies will be to gather information that is consistent with open records laws, but repeated or in-depth contacts with a state housing agency may be perceived as adversely impacting a taxpayer's reputation or future ability to obtain allocations of credit.

Therefore, state agencies should not be contacted about specific taxpayers without first providing notice to the taxpayer. Agents should use Letter 3164E.

The best way to find your state agency contact is through the National Council of State Housing Agencies (NCSHA), which is a national, nonprofit organization created by the state housing agencies to assist them in increasing housing opportunities for lower income and underserved people. The NCSHA supports a website (www.ncsha.org) which includes links to the individual state housing agencies' websites, where you can find general information about the agency and contacts.

? Grace Notes ?

On August 26th, A&E aired a segment of Investigative Reports titled "Wage Slaves: Not Getting By in America". Frankly, not the kind of show I generally want to spend my "escape" time watching. However, because of my involvement with the LIHC program, I knew it was a program I ought to watch…and I want to share some of the information with you.

The program takes a look at how people working for hourly wages live. These are people working long hours at physically exhausting, mentally challenging jobs. As the narrator described them, these people are not the fringes, but are the very fabric of society.

- *¼ of the American workforce earns between $7 and $8 an hour or about $15,000 a year*
- *77 million American live in near poverty – 24% earn $16,000 or less a year*
- *The federal minimum wage is $5.15/hour – that's $206 per week BEFORE taxes*
- *20% of children live in poverty*
- *75% of single-parent families with two or more children have incomes that fall below minimum subsistence budget levels*
- *25% of low-income families are unable to make rent or mortgage payments at some point in a 12 month period and 40% of Americans are just two paychecks away from homelessness*
- *75% of low-wage workers have a high school education or less*

Okay, I can really understand why one interviewee described being a wage slave as living with anxiety: waking up to anxiety and, at the end of an anxiety filled day, going to bed with anxiety. I'd be anxious, too.

The program presented opposing views and pointed out that being poor in America is still much better than being poor anywhere else in the world, and even better than the middle class in many parts of world…(it's all relative). And yes, the working poor do have access to many more consumer goods (that may help to mask their poverty), but two big ticket items are still beyond the grasp of the working poor – adequate health care and housing. According to HUD, the median cost of a home in 1970 was $23,000. In 2001, the median cost was $148,000. And as property values increase, so do rents. Unfortunately (and in defiance of economic principles of supply and demand) the supple of affordable housing has not increased to meet the demand.

In 1986, Congress created the Low Income Housing Credit (IRC §42). Most people agree that the program is successful – certainly, it is not the only program, and it is definitely not the only answer, but LIHC properties are intended to meet help meet housing needs of targeted groups such as the working poor.

The program is co-administered with state housing agencies, who identify the specific needs in their states, select projects best meeting those needs, and then monitor completed projects to make sure those needs are meet. Simply put, the IRS makes sure that owners of LIHC properties who agreed to, but didn't provide safe, decent, and affordable housing with properly restricted rents to qualified tenants, don't enjoy the benefits of federal tax credits.

So, you might ask, just how much housing doe the LIHC support? According to the National Council of State Housing Agencies, the state agencies allocated $462,352,901 in credits in 2001 for 67,398 new and rehabbed low-income housing units. That equals $6,860 per unit each year or $68,600 total over the 10-year credit period. Under federal law, however, the compliance period is 15 years, so now the cost is really $4,573 per year for 15 years.

Wait a minute…the taxpayer also agrees to an "extended use" of at least another 15 years. (See IRC §42(h)(6).) So if you divided that original $68,600 by 30, the cost of a low-income housing unit to the American taxpayer is $2,287 per year for 30 years.

Grace Robertson
Phone: 202-283-2516
Fax: 202-283-2240
Grace.F.Robertson@irs.gov