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!!

Reviewing Tenant Files

By Kent Rinehart, Revenue Agent

You're been assigned a Low-Income Housing Credit (LIHC) case with information about non-qualifying households or the state agency has report that the owner's paperwork appears incomplete. Where do you start?

First, review the property manager's procedures for qualifying new tenants. Does the owner have written procedures for the manager to follow? Determine how the property manager conducts interviews, contacts third parties for verification, and maintains the files. You'll also want to ask how the property manager handles certain scenarios; e.g., the total anticipated income for the upcoming year is less than what it will cost to reside at the property or a one-person household requests a three bedroom unit. If the property is near a college or university, how do they verify student status? How does the property manager know when it is time for the annual recertification? What happens when a tenant is determined to be over-income at recertification?

Then consider the property manager's internal controls. All tenants (18 years or older) should be asked the same questions and all the files should have the same documentation. Some basic questions include:

- Does the manager use a standardized income certification document?
- Is a management company involved? If so, what do they do? Is the management company related to the general partner (this is a common practice for LIHC properties)?
- Who reviews the property manager's work?

Finally, review the tenant files for the year under audit.

- Are the files complete?
- Are the files consistent from unit to unit and building to building?
- Are there notations explaining unusual circumstances?
- Were the files prepared timely and concurrent to the events or reconstructed after the fact?

Okay, you've talked to the property manager and owner, reviewed the tenant files, and the documentation reconciles to the tax return. Do you "no-change" this issue? Not just yet!

Income

Under IRC §42, the tenant is to provide the owner with information about the household and the total anticipated income they expect to receive during the next twelve months. Income includes, but is not limited to, earned and *unearned* income from household members age 18 and older, unearned income of minor children, and income from assets.

One quick audit technique is comparing the information in the tenant file with the income reported on the tenant's tax return. You can identify the tenant's wages, interest, social security, annuities, alimony, and other taxable sources. Generally, if the taxable income is more than the LIHC income limit, there's a potential problem.

The tenant file should include a list of all sources of nontaxable income. Nontaxable income includes, but is not limited to, deferred compensation payments, employer non-accountable allowances or reimbursements, nontaxable social security payments, insurance annuities, nontaxable retirement fund distributions, disability or death benefits paid, welfare assistance payments, child support, and regular contributions and gifts from person(s) not residing in the unit.

Together, the income per tax return and the nontaxable income per tenant files will provide you with an estimate to compare to the tenant's total anticipated gross income for each year. Generally, if the tenant's taxable and nontaxable income is about the same as the anticipated gross income shown on the tenant certification, there is no issue. On the other hand, if there is a discrepancy, further analysis will be needed to determine whether the tenant is qualified.

Size of Household

Since the income limit is dependent on the size of the household, the next step is to determine whether the tenant's file reflects all the members of the household. Indicators of potential problems include:

- One name on a lease for a unit with multiple bedrooms,
- The tenant's income (as reported in the file) is not sufficient to pay the rent and a reasonable estimate of living expenses,
- Rent payments from more than one person,
- Separate leases for amenities, such as garage space. You may find different names for rental of garage space than names on the rent roles.

Request a listing of all the tax returns filed with the LIHC project's address. If there are more names than the taxpayer provided, you probably have unrecorded household members.

Analysis

Analyzing all this information is not an exact science. You will need to evaluate the property manager's diligence and efforts to identify qualified tenants and satisfy yourself that you've accounted for all tenants for each unit of the property.

Basically, you are looking for what doesn't make sense. It is important for you to question certain things that are inconsistent with tight budgets. For example:

- Why would one tenant want to rent a three-bedroom apartment?
- How can this tenant pay for expenses when total income is less than half of what it costs to live in the unit?
- Why are there two separate rent payments being recorded each month for a unit with only one individual listed as the tenant?
- Why does this one tenant need two parking spaces?

If the facts don't add up, chances are there is an unrecorded tenant that the property manager knew, or should have known about.

Requirements for Participating Nonprofit Entities

Grace Robertson, Program Analyst

Under IRC §42(h)(5), Congress provided additional tax incentives for qualified nonprofit organizations to be involved in the development and management of IRC §42 properties. The nonprofit (usually a general partner with less than a 1% interest) is subject to specific requirements.

Last October, TEGE released their CPE material for 2002, which included a chapter on determining whether a nonprofit entity participating in the LIHC program is a qualified tax-exempt organization. The text was released to the public and has heightened awareness of the requirements for nonprofits participating in the program.

10% Set-Aside

Under IRC §42(h)(5), the state agencies responsible for allocating the low-income housing credit must set aside a minimum of 10 percent of their total credit ceiling for projects involving qualified nonprofit organizations. You can determine whether the LIHC project received an allocation from the 10% Set-Aside by contacting the state agency. If the taxpayer did not receive the credit allocation from the 10% Set-Aside, then the entity is not subject to the nonprofit rules.

Qualified Nonprofit Organizations Defined

A qualified nonprofit organization is any organization meeting the tax-exempt requirements of IRC §§501(c)(3) or 501(c)(4), and for which one of the charitable purposes includes the fostering of low-income housing.

Examiners can confirm that the nonprofit entity is a qualified tax-exempt organization by using the IRS website (www.irs.gov). Enter "78" into the "Search IRS site for" feature; the response will be "Most likely you are looking for Publication 78, Search for Exempt Organizations"; clicking on the underline portion will provide an alphabetical listing of exempt organizations.

Rev. Proc. 96-32, 1996-1 C.B. 717, provides guidance for determining whether a qualified nonprofit organization involved in low-income housing is pursuing a charitable purpose by fostering low-income housing; the determination is based on the percentage of low-income units provided and the income level of the tenants. These guidelines are applicable continuously throughout the 15-year compliance period. An organization must establish (for each project) that at least 75 percent of the units are occupied by residents whose incomes are 80 percent or less of the area's median gross income, and either

- 40 percent of the units are occupied by residents whose incomes are 60 percent or less of the area's median income, or

- 20 percent of the units are occupied by residents whose incomes are 50 percent or less of the area's median income.

Ownership Test

Qualified nonprofit organizations must have an ownership interest in the low-income housing project throughout the 15-year compliance period. The nonprofit can own an interest directly, or indirectly through a partnership, or own stock in a qualified corporation that owns a low-income housing project. A qualified corporation must be a corporation that is 100-percent owned at all times during its existence by one or more qualified nonprofit organizations.

Material Participation

The qualified nonprofit organization must materially participate in both the development and operation of the project throughout the 15-year compliance period. IRC §469 is referenced as the definition of "materially participate"; IRC §469(h) defines material participation as activity that is regular, continuous, and substantial. Treas. Reg. 1.469-5T further defines "material participation" for individuals, but the general guidance can be used to address a nonprofit's requirements.

- The nonprofit must participate for more than 500 hours during the year; or
- The nonprofit's participation must constitute substantially all of the participation; or
- The nonprofit's participation must be more than 100 hours during the year, and this participation is not less than the participation of any other owner of the property; or
- The nonprofit's participation in multiple projects must exceed 500 hours, or
- Facts and circumstances show that the nonprofit's participation was on a regular, continuous and substantial basis.

Maintaining Control

Under IRC §42(h)(5)(C)(ii), the qualified nonprofit organization must maintain control over the partnership; that is, a developer acting as a co-general partner cannot control the partnership. The qualified nonprofit and for-profit organizations should not be related parties; i.e., share officers or board of directors. Such relationships may indicate that that the sole purpose of the nonprofit organization is to pass on the tax benefit to the related entity and shared officers.

The question is whether the nonprofit organization acts exclusively in furtherance of a charitable purpose or does the partnership (other partners) cause the organization to further the interests of private investors? Although there is no all-inclusive list, here are some indicators that the nonprofit entity is not acting exclusively to further the charitable purpose.

- The nonprofit not the only general partner,
- The nonprofit's minority general partner interest provides for minimal control over the LIHC operation,
- The nonprofit makes guarantees to the limited partners against loss of low-income housing credits, or
- Excessive private benefit resulting from real property sales, development fees, or management contracts,

LIHC Adjustments

As a matter of Compliance policy, the low-income housing credit will be disallowed in its entirety for the period of time that the nonprofit:

- is not a qualified tax-exempt organization,
- did not meet the requirements of Rev. Proc. 96-32,
- was controlled by a for-profit organizations, or
- did not materially participate in both the development and on-going operation of the project.

Owners may be able to correct the noncompliance and resume claiming the credit. For example, if the nonprofit losses its tax-exempt status, another qualified nonprofit entity may be substituted. However, depending on the facts, the credit may be permanently disallowed, which will trigger a credit recapture event under IRC 42(j).

? Grace Notes ?

Happy Holidays!!!!!

& Thanks for all your help and support!

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