

Low Income Housing Credit Newsletter

Internal Revenue Service

Issue No. 9

April 2003

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!!

A New Voice in Philadelphia

By Angie Kaminski, Compliance Unit Manager

The states of Alaska, Georgia, Idaho, Indiana, Maine, New Mexico, Texas, and West Virginia all have a new contact person at the Philadelphia Campus. We welcome Jim McGoldrick to the LIHC Team. His phone number is (215) 516-7668. He may not have all the answers yet, but he knows how to get them!

First Year Applicable Fraction – Not as Simple as the Months in Service Divided by Twelve

by Nancy Rudolph, Revenue Agent

I have recently done two different LIHC cases. In both cases, the credit claimed by the taxpayers was computed by taking the total state allocation and multiplying it by a months-in-service fraction (number of months in service divided by 12 months in a year). Each taxpayer failed to consider their actual occupancy in the fraction.

IRC § 42(f)(2) provides for a special rule for the first year of the credit period. This section determines the first year credit by summarizing an applicable fraction for each month a building was in service during the initial year based on the percent occupied by low-income residents.

For example, suppose a taxpayer does not elect to defer the credit (see line 10a of Form 8609) to begin the first year after the building is placed in service. The building is placed in service September 10, 2001.

Low-income occupancy applicable fractions:

January – September	0 %
October	60 %
November	80 %
December	<u>100 %</u>
TOTAL	240 % / 12 months = 20%

A fraction for September is not included above because the building was not in service for a full month.

The part year fraction is both applied to the qualified basis and the state allocation. Therefore, if the state allocates \$100,000 in credits and the applicable fraction is 20%, then the first year credit is limited to \$20,000 (\$100,000 times 20%).

This was an easy and substantial adjustment in both cases. Therefore, any time a taxpayer wants to claim a credit during the initial year, make sure they are in compliance with IRC § 42(f)(2) both in applying the fraction to qualified basis and to the state allocation.

Report Writing for an Unagreed Case—Getting Appeals and Others to Understand IRC § 42

By Kent Rinehart, Revenue Agent

For an agreed case, the shorter the explanation of items—the better—so long as the taxpayer agrees and signs the report.

But no matter how simple an LIHC issue appears to be, if the taxpayer does not agree, it is important to fully develop all aspects of each issue so that your manager, Appeals, and Counsel fully understands the issues and computations in your report.

To help with this, IRM § 4.10.7 focuses on Issue Resolution and all the legal authorities the IRS may use to make its case. The overview states that it is imperative that examiners identify the applicable law, correctly interpret its meaning in light of congressional intent, and, in a fair and impartial manner, correctly apply the law based on the facts and circumstances of the case.

And for unagreed cases, IRM § 4.10.8.10.2 describes what is involved with the preparation of Form 886-A, Explanation of Items. My personal experience has been that the two toughest areas for any unagreed Explanation of Items is the Applicable Law and the Argument sections.

For LIHC issues, Applicable Law includes, but is not limited to, everything from the Code (current and prior provisions), Federal Tax Regulations, Committee Reports (House, Senate, etc.), Code of Federal Regulations, Revenue Procedures, Revenue Rulings, Notices, IRS Publications (including form instructions and worksheets), tax cases, Private Letter Rulings, and more.

Also, LIHC issues are often intertwined with guidelines from the Department of Housing and Urban Development (HUD). Their manual also provides supplemental authority for determining the Area Median Gross Income and the income limits for qualifying tenants.

It may also be necessary to cite from the manuals and other authorities that each State Housing Agency uses to allocate and monitor the credits issued to taxpayer.

A taxpayer may even support a position by using hearsay, or oral testimony, from a person at the IRS, HUD, State or some other authority. They might even have a written document from someone that they are using to support their position.

Therefore, it is important for examiners to clearly illustrate, in narrative form, everything and everyone the taxpayer relied on in reflecting any amount in question on their return. The date of the evidence, the source of the evidence, and the authority of the evidence should be reflected in the explanation of items.

Examiners must show all of the different perspectives (IRS, HUD, State, etc.), law, guidelines or other authority that supports or refutes the taxpayer's position. Once all laws and arguments have been exhausted, examiners can arrive at their conclusion based on all this information.

As an examiner with an unagreed case, your goal is to convey everything you know about the issue to all interested parties. LIHC issues are unique and unfamiliar to many throughout the IRS. The more information they have about the entire issue—the better chance the issue can be resolved in a fair and equitable manner.

Overall, for any unagreed LIHC case—a bigger Explanation of Items is a better one!

Nonprofit Entities—Are they involved and do they have direct control?

by Christopher Ropa, Revenue Agent

IRC § 42(h)(5) provides that a portion of a State's LIHC ceiling will be set-aside for projects involving qualified nonprofit entities. At first glance, having a nonprofit entity involved might lend credibility to any LIHC project. However, one question that needs to be asked is: How involved are they?

In a memorandum dated January 13, 2003, from the Director, Reporting Compliance, the requirements for participating qualified nonprofit organizations are identified. Two of the requirements cited pertain to "material participation" and "maintaining control."

For material participation, the nonprofit participation must be determined to be one of the following:

- More than 500 hours during the year; or
- Constitute substantially all of the participation; or
- More than 100 hours during year and this participation is not less than any other owner; or
- Participation in multiple projects must exceed 500 hours, or
- Participation was regular, consistent and substantial

For maintaining control, the following are indications that a nonprofit does not have sufficient control over an LIHC project:

- Nonprofit is not the only general partner,
- Nonprofit's minority general partner interest provides for minimal control over the LIHC operation,
- Nonprofit makes guarantees to limited partners against loss of low-income housing credits, or
- There is an excessive private benefit resulting from property sale, development or management.

One document that establishes who participates and controls an LIHC partnership is the partnership agreement. The agreement should stipulate who has direct control, and to what extent, as well as who has the ultimate decision-making responsibility for the entity.

Other documents that need to be inspected include all management agreements, including all third party management company contracts. Examiners need to identify all parties responsible for making any decision pertinent to the operations of the LIHC project.

In the case of third party management companies, the examiner needs to determine whether the management company is acting as an agent of the taxpayer. This is

particularly important in determining whether or not the nonprofit owner materially participated.

Then, an analysis needs to be made of the project's internal controls to see how each decision-making process works. The question to be answered is: Exactly who is making the key decisions for the taxpayer?

The fact that an entity is labeled as nonprofit or tax-exempt does not mean that it is automatically compliant with the LIHC program.

If it is determined that a qualified nonprofit is not materially participating or maintaining control, then they are not allowed to claim LIHC received under IRC § 42(h)(5). However, owners may be able to correct the noncompliance and resume claiming LIHC. For example, if the nonprofit loses its tax-exempt status, another qualified nonprofit 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).

Uniform Documentation Required to Comply with IRC § 42

By Kent Rinehart, Revenue Agent

A memorandum dated August 25, 1999, from the National Director, Compliance Specialization, clarifies the State housing agencies' authority to require standardized documentation of compliance with IRC § 42.

IRC § 42(m) outlines responsibilities of housing credit agencies for administering the program, including procedures for monitoring taxpayer compliance after receiving credit allocations. Federal Tax Regulation 1.42-5 outlines procedures state agencies must follow to monitor for noncompliance. Further, § 1.42-5(a)(2)(ii) specifically provides that monitoring procedures may contain additional provisions or requirements.

The IRS determined that because the compliance monitoring regulations under IRC § 42 established minimum standards, Agencies have the right to control the documentation required within their jurisdiction to fulfill their compliance monitoring responsibilities as outlined in Federal Tax Regulation 1.42-5(c)(2)(ii)(C), including the use of standardized forms or documents.

It is also reasonable for Agencies to request new or additional documentation from an owner, if they determine that the documentation provided by a property owner is not adequate. And, if such inadequate

documentation prevents an Agency from determining if a project is in compliance with IRC § 42, then the Agency can properly hold that the project is out of compliance.

This memorandum continues to be in effect today as Agencies continue to make their own monitoring procedures more efficient and effective to ensure compliance with the LIHC program.

“I don't have Form 8609!”

by the Acting Answering Service for Grace Robertson

I've received a number of different phone calls about Form 8609, Low-Income Housing Credit Allocation Certification. And having worked cases where taxpayers claimed LIHC without any Form 8609—or claimed more LIHC than what was allocated on Form 8609—I wanted this opportunity to convey to readers my perspective of the importance of this form.

IRC § 42(l) provides for the certifications and other reports to the Secretary that are required of all taxpayers. In short, a Form 8609 must be filed before any credits are claimed.

If a taxpayer wonders how they can claim the credit on their initial return if they do not have Form 8609, the best answer is to file an extension and an amended return when a valid and signed Form 8609 is received from the State Housing Agency.

Along with having Form 8609, the form's Part II, First-Year Certification is equally important. IRC § 42(l)(1) provides that in the case of a failure to make the certification required on the date prescribed, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable by with respect to such building before such certification is made.

Therefore, Form 8609 and the first year certification go hand in hand. And, no credits are allowed until a valid Form 8609, including the first year certification are submitted to the IRS.

You, as an examiner, will need to consider any reasonable cause presented by the taxpayer and the certification can be made as part of the audit.

Some of this information can be corroborated with the State Housing Agency or some other reliable third party (e.g., extended use agreement). Other information may not be so readily available and examiners will need to review taxpayer's overall due diligence in handling all paperwork associated with the LIHC project.

When considering reasonable cause, examiners should analyze all documents the taxpayer provided the State Housing Agency. Some factors to consider are:

- Was the information provided by the taxpayer complete and accurate or was it necessary for the State Housing Agency to repeatedly follow up with the taxpayer for more information.
- Was the information submitted by the taxpayer timely or is there evidence of unnecessary delays.
- Were there extenuating circumstances that delayed the Form 8609 from being finalized (e.g., owner did not secure permanent financing).
- What actions did taxpayer initiate with the State Housing Agency and what responses were received pertaining to why Form 8609 was not issued.

The fact remains that a taxpayer is not entitled to any LIHC until they have Form 8609 in hand. Therefore, the burden of proof will weigh heavily on the taxpayer to show reasonable cause in claiming any credit prior to being issued a Form 8609 by a State Housing Agency.

The importance of Form 8609 for the LIHC program is analogous to Form W-2 for wage earners that have federal and state income taxes withheld from their pay. Wage earners can't file a return reflecting any income tax withholding on their return unless it is supported by a Form W-2 attached to the return. Likewise, why should any LIHC be claimed by a taxpayer that does not have Form 8609 from the State Housing Agency?

In classifying LIHC returns for examination, the first thing we look for is a valid Form 8609 attached. If none is attached, then examiners will need to closely scrutinize any reasonable cause offered by the taxpayer.

? Kent's Comments ?

"Relax! Grace is still in charge!"

She is still editor-in-chief and is the National Contact for the LIHC program. She is allowing me to step into her shoes for a few weeks. (It's just that I'm a bit taller and they don't make her shoes in my size!)

Grace and I are here to assist you with any question, concern, or suggestion you have about the LIHC program. We welcome your input and want you to share your accounts of cases that we can share with others in this newsletter.

Understanding all aspects of IRC § 42 is not easy. This newsletter gives you the "bigger" picture of the LIHC program from the perspective of National Office to that of examiners in the field. The perspectives we share from all of you will help all of us with future LIHC issues. Keep up the good work!

You can find me on Outlook. For the rest of the story, you can always contact:

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