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 Technical Guidance Website Includes LIHC Information

Reporting Compliance has launched a new website called Technical Guidance, which is designed to assist technicians with the day-to-day examination work. There is a section for the Low-Income Housing Credit. You'll find the ATG and position papers for specific issues, back issues of the LIHC Newsletters, contacts, and research material.

The address is **http://sbse.web.irs.gov/tg/**, then go to the "Industry and Issues" tab on the home page to find the link to Low-Income Housing Credit. The website is for internal use only, and is not available to the public.

"Calling" A Bond: Procedural Update

Under IRC §42(j)(1), if, at the end of any taxable year in the compliance period, the qualified basis of any building is less than it was at the end of the preceding taxable year, then the taxpayer must recapture the accelerated credit associated with the decreased qualified basis; i.e., there has been a disposition of property, or an interest therein, or a reduction in qualified basis for another reason.

In the case of a disposition of property, recapturing the accelerated credit can be avoided if an owner selling a building, or interest therein, posts a bond equal to the amount specified on Form 8693, Low Income Housing Credit Disposition Bond, and the LIHC project is expected to remain in compliance for the balance of the compliance period. As an alternative, under Rev. Proc. 99-11, taxpayers can pledge certain United States Treasury securities to the IRS as security.

When a LIHC noncompliance issue is identified during an audit that triggers the LIHC recapture provisions, examiners should include an adjustment to recapture the accelerated portion of the credit for <u>all</u> prior years of the credit period, as well as disallowing the low-income housing credit in the year under audit. In the event that the taxpayer under audit is not the owner throughout the compliance period, it will be necessary to "call" the bond to recapture the accelerated portion of the credit from the previous owner(s).

<u>Audit Techniques</u>

To timely identify properties that have changed ownership, examiners should:

- Ask the taxpayer during the initial interview,
- Compare the name and EIN on the Form 8609, Low-Income Housing Credit Allocation Certification, to the name and EIN on the tax return, and
- Review the Schedules K-1 from the prior, current and subsequent year returns to identify changes in the partnership ownership. (Schedule K-1 includes a line to be checked if it is the partner's final K-1.)

Since the entity under audit is providing affordable housing, it is likely that a prior owner placed a bond with the IRS. The LIHC Compliance Unit at the Philadelphia Campus maintains the bonds and Form 8693. If a prior owner is identified, call Sam Aloi at 215-516-7609 for information about existing bonds. Be prepared to provide the building identification numbers (BIN).

<u>Audit Adjustments: Identified Prior Owner</u>

If the audit of a LIHC property results in the recapture of accelerated credits, then:

- The audit report for the taxpayer under audit should be limited to recapture of accelerated LIHC for the years the taxpayer owned the property.

- When the case is settled, the LIHC Compliance Unit will be provided the following information. The information should be provided without regard to whether a prior owner posted bonds.

  1. Copy of the audit report indicating the adjustments to the LIHC, the reasons why, and the taxpayer's agreement report.

  2. A schedule indicating all BINs, the years impacted, and the amount of the accelerated credit to be recaptured for each year. The LIHC Compliance Unit will calculate the interest portion of the recapture.

The information should be sent to:

Internal Revenue Service SB/SE
Attn: Sam Aloi, Drop Point 607 South
Philadelphia Campus
P.O. Box 331
Bensalem, PA 19020

New Revenue Ruling for Community Service Facilities

As part of the Community Renewal Tax Relief Act of 2000, IRC §42(d)(4)(C) was added to include property used to provide services to nontenants as part of the eligible basis used for determining the LIHC amount. There are specific requirements:

1. The property must be located in a qualified census tract. (See IRC §42(d)(5)(C)(ii)(I).)

2. The property must be subject to the allowance for depreciation and not otherwise accounted for.

3. The property must be used throughout the taxable year in providing any community service facility.

The law applies to credit allocations after 2000 or, if the building does not need an allocation under IRC §42(h)(4), buildings placed in service after 2000.

Community Service Facility Defined

Under IRC §42(d)(4)(C)(iii), a community service facility must be designed to service primarily individuals whose income is 60 percent or less of the area median income. According to the revenue ruling, the requirement is satisfied if the following conditions are met:

- The facility must be used to provide services that will improve the quality of life for community residence; i.e., day care, career counseling, literacy training, education (tutorials), recreation, and out-patient clinical health care.

- The taxpayer must demonstrate that the service provided will be appropriate and helpful to individuals living in the area. This may be demonstrated in the market study required under IRC §42(m)(1)(A)(iii).

- The facility must be located on the same tract of land as one of the buildings that comprises the qualified low-income housing project.

- If fees are charged for the services, they must be affordable to individuals whose income is 60 percent or less of the area median income.

Limit on Cost

Under IRC §42(d)(4)(C)(ii), the cost of the community service facility cannot exceed 10 percent of the eligible basis of the qualified low-income housing project of which it is a part.

HUD Releases Revised Handbook 4350.3

HUD has released a new revision of their Handbook 4350.3, which includes guidelines for determining a tenant's income. The effective date is June 12, 2003.

The guidelines are used to determine whether a prospective household is income qualified for LIHC housing. To qualify for LIHC housing, each household must certify that their income for the 12-month period *following* the certification will be within the income limit. Income includes the income of the head, spouse or co-head, and other adult members of the household.

Guidance on Nonprofit Ownership of LIHC Projects Included on the 2003-2004 Priority Plan

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. 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.

Generally, it is an industry practice for investors (limited partners) in LIHC property to include guarantees and indemnification requirements in their partnership agreements with the general partner. When the general partner is a qualified nonprofit organization, the question arises as to whether the guarantees results in a profit motive sufficient to compromise the qualified nonprofit organization's charitable purpose and status under IRC §§501(c)(3) or 501(c)(4).

Chief Counsel has announced plans to update guidance addressing the requirements for qualified nonprofit organizations participating in the LIHC program. The guidance will help qualifying nonprofit organizations obtain exempt organization determination letters more quickly and provide criteria for evaluating the operation of existing LIHC properties that received LIHC allocations under IRC §42(h)(5).

Regulation Project to Update Rules for Utility Allowances

Under IRC 42(g)(2)(B), the maximum rent that may be paid by the tenant is to be reduced by a utility allowance. The rules for determining the utility allowance are included in Treas. Reg. §1.42-10.

Chief Counsel has received approval from the Treasury Department to open a project to review the methodologies used for determining the amount of the allowance. The IRS is concerned that there are barriers making it difficult for taxpayers to comply with the rules.

Frequently Asked Questions *(The States' Side)*

Question 1: Owners and property managers want to charge tenants a higher rent for month-to-month leases than for a longer-termed lease, such as six months. Is this okay?

Answer: The month-to-month lease "fee" is considered additional rent. As long as the rent plus the month-to-month fee plus the utility allowance doesn't exceed the rent limit, charging a month-to-month is acceptable. The important point is that it is considered part of the rent subject to restriction under IRC §42(g)(2).

Question 2: How is the compliance period calculated?

Answer: The compliance period begins on the first day of the taxable year that is the first taxable year of the credit period. In other words, the credit and compliance periods will begin in the same year.

For example, a building is placed in service on July 1, 2001. Most LIHC property owners are partnerships with taxable years beginning on January 1st, so the compliance period starts on January 1, 2001 and ends on December 31, 2015. See Internal Revenue Code §42(i)(1).

? *Grace Notes* ?

I'm back! And thanks to Kent Rinehart for taking over in grand fashion while I was gone.

As you can see, there are significant efforts being made to update the program and address issues directly impacting the production of LIHC housing and the accessibility to a growing population of households in need of affordable housing. We'll be talking more about the changes in the future, but I just want to take a moment to thank those who have worked to bring these efforts to completion....it takes a whole lot of patience!

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