

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!!

Fiscal Year 2005 LIHC Priorities

As we begin a new fiscal year, it is time to review the requirements and priorities for conducting examinations of tax returns on which the LIHC under IRC §42 is claimed.

Issue Identification

State level housing agencies are responsible for monitoring LIHC properties for compliance. When noncompliance is identified, the state agencies notify the IRS using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition. These reports of noncompliance are the primary source of information for selecting returns for audit.

Case Building

Returns sent to the field for audit will include case building documents including a classification checklist identifying audit issues, copies of Forms 8823 and supplemental explanations submitted by the state agency, and technical guidance for specific LIHC issues.

Minimum Audit Requirements

At a minimum, examiners should complete the following minimum audit procedures:

- Noncompliance – determine the extent that the noncompliance identified by the state agency still exists.
- Eligible Basis – review the taxpayer's records to confirm that only allowable costs have been included in the computation.
- Habitation Standards – tour the property to ensure that the property is well maintained and suitable for occupancy.

- Tenant Eligibility – review the taxpayer's tenant files to ensure that households are properly qualified as eligible for LIHC housing.
- Rent Limits – ensure that the restricted rent is correctly computed and allowances under IRC §42(g)(2) are correctly computed.

Failure to Certify under IRC §42(l)

If the taxpayer cannot provide Forms 8609, Low-Income Housing Credit Allocation Certification, signed by the state agency, then the entire LIHC should be disallowed and accuracy-related penalties considered because the taxpayer has knowledge that the completed building/project was not approved by the state agency and the taxpayer is attempting to circumvent the certification requirement under IRC §42(l).

LIHC Recapture under IRC §42(j)

If the state agency has reported an LIHC recapture triggering event, or that the taxpayer is no longer participating in the program, the audit can be limited to consideration of the recapture provisions under IRC §42(j).

The LIHC recapture adjustment has two components; (1) the amount of accelerated LIHC claimed in prior years (IRC § 42(j)(2)(A)) and interest, at the *overpayment* rate, for each prior taxable period that accelerated LIHC was claimed, starting with the due date for filing the return for each prior taxable year involved (IRC § 42(j)(2)(B)) and ending on the due date of the return under examination. From that point forward, the regular *underpayment* interest rate will apply to the LIHC recapture adjustment and any other adjustments made to that return.

Investor Returns

Investor returns are also selected for audit when the taxpayer failed to correctly recapture the LIHC under IRC §42(j) or did not correctly and/or timely secure a surety bond/securities under IRC §42(j)(6).

Getting a LIHC Recapture Adjustment onto the Examination Report

IRS software for examination reports is continuously updated and upgraded. Here are some tips that will get your LIHC recapture adjustment on your report.

For individual and C corporation returns, LIHC recapture is the equivalent to an “Other Tax” adjustment. For flow-through entities, LIHC recapture will be a Schedule K adjustment that ultimately flows to each respective return that claimed the accelerated LIHC.

Historically, the software that the IRS has used did not provide a clear or exact title for an LIHC recapture adjustment. The key is to ensure that the “Other Tax” or “Schedule K” adjustment amount on your report matches your adjustment for the LIHC recapture issue. Then, you can better illustrate and explain how you arrived at the total recapture amount in your Explanation of Items that accompanies the examination report.

In the Explanation of Items, you should clearly illustrate how the total LIHC recapture amount was determined. Because LIHC recapture amount is the total of the accelerated LIHC plus interest, it is recommended that you reflect each adjustment year by year to explain how the recapture amount was computed.

The accelerated portion (IRC § 42(j)(2)(A)) of LIHC claimed in prior years is the easiest component of the overall recapture adjustment. A taxpayer will know what LIHC was allowable for a building in prior years and can also determine one-third of this amount for each year.

The interest component of the recapture adjustment is a bit more complex. In its simplest context, once you know the accelerated portion of LIHC to recapture in each year, you compute

interest, at the overpayment rate, from the due date of each return on which accelerated LIHC was claimed through the due date of the return you are examining.

Therefore, if you are recapturing from five prior years to the year you are examining, you will need to make five different interest computations under IRC § 42(j)(2)(B). Each computation will have a different start date for interest, but have the same ending date.

Overall, the amount of any recapture interest on accelerated LIHC is computed through the due date of the return you are examining. From that point forward, underpayment interest will apply to the LIHC recapture amount as it would for any other issue that you adjust during your examination.

Just remember, your examination report simply needs to reflect the proper number as an “Other Tax” or “Schedule K” adjustment—your Explanation of Items can do all the rest.

Transferring Tenants Between Buildings Under Rev. Rul. 2004-82

Rev. Rul. 2004-82, Q&A #8, provides guidance for transferring a tenant to a LIHC unit in a different building.

Q-8: On July 1, 2003, an income-qualified household (Household) initially occupied a rent-restricted residential rental unit in Building 1 of Project. On October 31, 2003, the property manager moved Household (and transferred Household's lease) to a similar rent-restricted unit in Building 2 of Project that was not previously occupied. Household occupied the Building 2 unit at the end of 2003. The unit Household vacated in Building 1 was unoccupied during November and December. Are both units in Buildings 1 and 2 low-income units at the end of 2003?

A-8: No. While a vacant low-income unit generally retains its character as a low-income unit, where an owner simply moves a tenant from a unit in one building to a unit in another building in the same project, both units may not be treated as low-income units; rather, only the unit that the tenant actually occupies at the end of a month in

the first year of the credit period and at the end of each year in subsequent years qualifies as a low-income unit. Thus, in this situation, while the unit in Building 1 vacated by Household was treated as a low-income unit during the months it was occupied by Household, the unit ceased to be treated as a low-income unit when Household vacated the unit. At that time, the vacated unit would be treated as a unit not previously occupied.

Follow-Up Questions

Question 1: Must the household certify as a new household when they move to a different building?

No. The lease, as well as the underlying income certification, moves with the household to the new LIHC unit as part of the transfer.

Question 2: Does it matter why the tenant moves?

No. The household moved at request of the owner in the revenue ruling example, but a transfer can occur at the request of the household as well. The purpose of this rule is to increase the owner's flexibility and ability to accommodate a household's changing needs without jeopardizing the LIHC.

Question 3: If a tenant moves out of a unit in building A during the first taxable year of the credit period to occupy a unit in building B and the unit in building A is not occupied by a qualified household by the end of that first year, will the LIHC unit in building A qualify for the full credit?

No. The unit in building A swapped status with the unit in building B, and is considered to be a "never occupied" unit at the end of the year. Under IRC §42(f)(3), the Applicable Percentage is 2/3 of the applicable percentage used for units first occupied during the first year of the credit period and the first year computation rule.

Question 4: Does the rule apply throughout the compliance period, or just the first year?

The rule applies throughout the 15-year compliance period.

Question 5: What is the household's income is more than 140% of the income limit at the time of the transfer?

The units "swap" status. The unit the household moves to turns into an "over-income" unit subject to the Next Available Unit Rule.

Resident Managers' Units: Treatment Under Rev. Proc. 92-61

Under Rev. Rul. 92-61, a unit occupied by a full-time resident manager is included in the Eligible Basis of a qualified low-income building under IRC §42(d)(1), but the unit is excluded from the applicable fraction under IRC §42(c)(1)(B). The unit is considered a facility required for the benefit of the project.

Question 1: Must the resident manager be income eligible for LIHC housing?

No, the resident manager is not required to be income qualified.

Question 2: Can the owner charge the resident manager rent?

No, the unit is considered a facility required for the benefit of the project. If the owner charges the resident manager rent, then the unit is a rental unit and must be included in denominator when calculating the Applicable Fraction. The unit is a market rate unit if the resident manager is not income-qualified and/or the rent not restricted.

Question 3: Can a unit be turned into a LIHC rental unit if no longer needed for a resident manager?

Yes. Changing a unit from a resident manager's unit to a LIHC rental unit is permissible. The unit will be included in the numerator and denominator of the Applicable Fraction for that year. Rev. Rul. 92-61 addresses this circumstance.

Question 4: If a unit is no longer needed as a resident manager unit, can a unit be used for another purpose that qualifies as a facility required for the benefit of a project?

Maybe. Since the state agencies generally approve the use of a rental unit for a resident manager, an owner should make sure the state agency approves any alternative use. Once the state agency's approval is secured, an owner needs to request a private letter ruling to obtain IRS approval since

Rev. Proc. 92-61 is specific to the use of a LIHC unit as a resident manager's unit and cannot be cited as authority using a LIHC rental units for other purposes.

Treatment of Application Fees: PLR 9330013

Application fees may be charged to cover the actual cost of checking a prospective tenant's income, credit history, and landlord references. The fee is limited to recovery of the actual out-of-pocket costs; no amount may be charged in excess of the average expected out-of-costs for checking tenant qualifications at the project.

As an alternative, it is also acceptable for the applicant to pay the fee directly to the third party actually providing the applicant's rental history.

Documenting Households with Zero Income

Under Regulation 1.42-5(b)(1)(vii), owners of LIHC properties must document each low-income tenant's income certification with documents such as federal income tax returns, Forms W-2, etc. But, how far does the IRS expect a LIHC property manager to go when a prospective tenant claims to have zero income?

The regulation cited above makes an exception for tenant receiving housing assistance payments under Section 8. The requirement is satisfied if the public housing authority provides a statement to the owner stating that the tenant's income doesn't exceed the income limit.

In other cases, the prospective tenant may sign an affidavit attesting to the fact that they have no income. But, like verifying assets with a value of \$5,000 or less with affidavits, owners may not rely on a low-income tenant's signed, sworn statements if a reasonable person would conclude that the tenant's income is higher than what the tenant has represented. In such cases, the owner must obtain other documentation of the low-income tenant's annual income to satisfy the documentation requirements.

The best way to determine whether a prospective tenant is income qualified is to conduct a detailed interview with the tenant. An interview can be used to follow up on information disclosed on the application, surface information that would not otherwise be known, and help the property manager make an informed decision.

Here are some questions that might be helpful.

- Ask if the prospective tenant has held a job or worked in the past. If the tenant has a work history, why isn't the tenant working now, or seeking employment? If the tenant *doesn't* have a work history, ask how the prospective tenant covered their expenses for the past year.
- Ask whether the prospective tenant has income from specific sources – workman's compensation, unemployment insurance, an inheritance or an allowance from a trust, for example.
- Ask how the prospective tenant intends to pay for living expenses, such as groceries and clothing in addition to rent for the next year (less than \$5,000 per year equates to total expenses of less than \$417 per month).
- Ask to see documentation of checking and saving account balances. If bank statements are provided, inspect the extent of deposits and withdrawals into and out of the accounts provided. Follow up to determine how the prospective tenant was able to save money.
- Ask to see loan documents; who is making the loan and how does the prospective tenant intend to repay the loan?
- Ask whether the prospective tenant has had roommates in the past. Any additional roommate can share living expenses and make a big difference. A tenant may not be hiding income from you, but may be hiding the fact that an additional tenant will be occupying the unit!

There will always be situations where it will be difficult to estimate income or determine the prospective tenant's intent. While we are discussing prospective tenants with zero income, the concept is equally applicable to tenants that

work sporadically or seasonally. In such cases, property managers and owners are expected to make reasonable judgments as to how to best estimate the income the tenant will receive in the coming year.

Ultimately the prospective tenant may be accepted as a resident of LIHC housing, and a detailed (and well documented) interview is good evidence that a property manager is applying the necessary due diligence.

New Address for Grace Robertson

Please send all correspondence to:

Grace Robertson
Program Analyst, Examination Specialization &
Technical Guidance, SE:S:E:EP:ESTG
Internal Revenue Service
1111 Constitution Ave, NW, NCFB C9-466
Washington, DC 20224

LIHC Compliance Unit Address

Need to send something to the LIHC Compliance Unit in the Philadelphia Campus? Here's the address that will get all correspondence (postcards to boxes) directly to the group:

Internal Revenue Service
P.O. Box 331
Attn: LIHC Unit, DP 607 South
Philadelphia Campus
Bensalem, PA 19020

Updated Project Code – 0670

Project Codes are now four digits. Please make sure that your LIHC cases are properly identified as Project Code "0670"; the tracking code is still 9812.

"Y" Freeze Code & Surveying LIHC Returns After Assignment

LIHC Cases include a "Y" Freeze Code. Should it become necessary to survey a LIHC return, please complete Form 1900 and submit to Program Analyst Grace Robertson for approval. The form can be transmitted by fax (202) 283-2240 or by e-mail to Grace.F.Robertson@irs.gov.

♪ Grace Notes ♪

I thought I'd do something simple this time, and just find some Thanksgiving trivia on the Internet. But as I wandered around the net I couldn't find anything I really liked, and my mind began to wander, too

I thought about my early Thanksgivings, when my brother (ten years my senior) was still living at home and how adding just two close family friends around the tiny kitchen table created a logistics problem - no one could reach the gravy!

I remember the Thanksgiving when my cousins showed up - all of them! So Thanksgiving dinner was suddenly moved to the garage and dinner was served on a table made of plywood and saw horses while a fire blazed in the old coal stove.

There's the Thanksgiving spent with friends while living far away from home. We scrounged up two cans of soup (different flavors) that we mixed together, made rice salad (mostly rice), and miraculously, three tiny puckered apples turned into pie enough for all. Dinner tasted as wonderful as any of the feasts my mother prepared!

There are other memorable Thanksgiving dinners with unrecognizable dishes (duck?), new recipes (rum cake, anyone?), and unusual traditions like a spaghetti dinner! And, of course, there are all the Thanksgivings in between, whether with family or friends, as hostess or guest, among strangers, or celebrated in solitude.

But it really wasn't the menu that mattered then, or that is important now. It is the gratitude we feel and the thanks "giving" we express - all in our own individual way, wherever we may be.

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