Low-Income Housing Credit Newsletter

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The LIHC newsletter provides a forum for networking and sharing information about IRC §42, the Low-Income Housing Credit, and communicating technical knowledge and skills, guidance and assistance for developing LIHC issues. We are committed to the development of technical expertise among field personnel. Articles and ideas for future articles are welcome!!

The contents of this newsletter should not be used or cited as authority for setting or sustaining a technical position.

In This Edition

Guide Available on IRS Website

The Guide for Completing Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition, is now available on the IRS website, www.irs.gov. Enter "ATG" in the search engine and select the first link on the list, which is a listing of Audit Technique Guides. Select "L" to move down to "Low-Income Housing Credit – Guide for Completing Form 8823." The Guide is available in both .pdf and html format.

Background

The "Guide" was written at the request of the housing agencies responsible for the administration of the IRC §42 program at the state level. Under Treas. Reg. §1.42-5, the agencies are responsible for monitoring taxpayers' compliance with IRC §42 requirements throughout the 15-year compliance period and reporting noncompliance to the IRS using Form 8823.

The Guide includes instructions for completing the form and guidelines for identifying and evaluating taxpayer compliance. Each of the 16 categories of noncompliance identified on the form is addressed in a separate chapter of the Guide.

The Guide was first released for use in January of 2007 and then significantly revised in October of 2009 to reflect changes made to IRC §§42 and 142(d) made as part of the Housing and Economic Recovery Act of 2008 (HERA). However, due to the extensive footnoting and technical issues, the Guide has not been available in an electronic format on irs.gov until now.

2011 Revisions

Asterisks are used to identify significantly revised text. A complete list of these changes is included with the Table of Contents. The text was also updated to correct typing and formatting errors, which do not change the meaning of the text, which are not identified.

Changes to Chapter 18

Noteworthy changes were made to Chapter 18, Owner Did Not Properly Calculate Utility Allowance, and are discussed here.

Out of Compliance

The "Out of Compliance" section has been revised to emphasize that low-income units are considered out of compliance when the gross rent exceeds the maximum gross rent limit. Further, the text now includes discussions and examples for the six noncompliance issues simply listed in the 2009 version of the Guide.

As originally released in March of 2011, Example 1 on page 18-10 included an error. The last sentence of the example should read, "The owner is out of compliance beginning July 1, 2010; i.e., an owner has *90* days to implement new utility allowances." This error, on page 168 of the pdf file, was corrected on May 20, 2011.

For three of the six noncompliance issues, the Guide also clarifies that there is a presumption that the maximum gross rent limit has been exceeded if:

1. Rents are not reduced for a utility allowance when utilities are paid directly by the tenant to the utility provider, even if the rent charged to the tenant is less than the maximum gross rent limits.

2. The owner did not review the basis on which the utility allowance is established at least once during both the prior and current calendar year; i.e., the utility allowance is not current.

3. The owner failed to maintain adequate documentation regarding the computation of utility allowances.

Back in Compliance

Other than the first paragraph and example, the entire "Back in Compliance" is new text and addresses the three noncompliance issues identified above.

Finally, to summarize:

1. Noncompliance is reported to the IRS whenever the rent paid by the tenant plus the correct utility allowance exceeds the maximum gross rent.

2. Noncompliance should not be reported to the IRS if:

   - Regardless of the error, correcting the utility allowance does not cause the rent to exceed the gross rent limit,

   - Noncompliance is corrected before the owner is notified of the state agency's review.

E-Filing "Bug" for Partnerships

Owners of IRC §42 projects are required to file Form 8609-A, Annual Statement for Low-Income Housing Credit. Part I, Compliance Information, satisfies the IRC §42(l)(2) annual reporting requirement. Part II is the computation of the credit for the tax year.

Key Points:

1. A Form 8609-A must be filed each year for the entire 15-year compliance period, even though no credit is allowable after the end of the 10-year credit period, except for the amount allowable under IRC §42(f)(2)(B) in the 11th year.

2. A Form 8609-A must be filed for each low-income building.

3. A separate Form 8609-A is filed for each allocation of credit. For every Form 8609, Low-Income Housing Credit Allocation and Certification, a corresponding Form 8609-A must be filed with the taxpayer's tax return.

4. The filing requirements also apply to low-income housing projects financed with tax-exempt bonds under IRC 142(d).

Owners filing Forms 8609-A also file Form 8586, Low-Income Housing Credit, which summarizes information from the attached Forms 8609-A.

<u>Partners in Partnerships</u>

If you are a partner in a partnership owning low-income housing, then you are required to file the Form 8586 only to report your share of the partnership's credit. You are not required to file Form 8609-A

<u>The E-Filing "Bug" and Temporary Fix</u>

It is quite common for a partner in a partnership owning low-income housing to be another partnership, for which the filing requirement is limited to the filing of Form 8586. However, the e-filing programming for partnerships does not distinguish between a partnership owning low-income housing and a partnership that is a partner in a partnership owning low-income housing. As a result, the programming requires completion of the Form 8609-A whenever the credit is claimed by a partnership.

So, to work around the programming when filing a partnership return for a partner in a partnership owning a low-income project, you will be asked to complete one "dummy" Form 8609-A.

Verifying Income and Assets

When determining whether a household is income-qualified, owners are required to verify the amount of income from all known sources of income, including the income derived from assets. Acceptable methods of verifying information include third party verifications, reviews submitted by the tenant (such as check stubs) and tenant certifications made under penalties of perjury.

Another source of documentation, specifically identified in Treas. Reg. §1.42-5(b)(viii) for households receiving housing assistance payments under Section 8 is a statement from the public housing authority declaring that the tenant's income does not exceed the applicable income limit.

The regulation reads:

> (vii) Documentation to support each low-income tenant's income certification (for example, a copy of the tenant's federal income tax return, Forms W-2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation)…In the case of a tenant receiving housing assistance payments under Section 8, the documentation requirement…is satisfied if the public housing authority provides a statement to the building owner declaring that the tenant's income does not exceed the applicable income limit under IRC §42(g).

Instructions for Rescinding Forms 8823

Every once in awhile, a state agency will need to rescind a Form 8823 filed with the IRS, so that the owner is treated as if the Form 8823 had never been filed. To rescind a Form 8823, a state agency must:

1. Write "Rescind" across the top of the Form 8823,

2. Check the "Noncompliance Corrected" box for every category previously marked "Out of Compliance,"

3. The date on line 9, Date Noncompliance Corrected, is the date the Form 8823 is signed, and

4. Mark the "amend" box in the upper right-hand corner of the form.

It is also helpful to include a note explaining what happened.

IRS Audits: What to Expect

Ever wondered what happens during an IRS audit? The IRS has released a new video called *Your Guide to an IRS Audit*. From the IRS website, **www.irs.gov**, enter "Audit" in the search feature or enter http://www.irsvideos.gov/audit/

Interviewing Taxpayers

The purpose of an interview with the taxpayer is to obtain an understanding of the taxpayer's background, financial history, business operations and internal controls, and books and records in order to evaluate the accuracy of such information.

- The interview should be held with the person(s) most knowledgeable about the development and on-going operation of the IRC §42 project. It may be necessary to interview more than one person.
- The interview should be held early in the examination as the interview is an opportunity to gather information that can help establish, and possibly limit, the scope and depth of the examination.
- Generally, interviews should be conducted after reviewing the documents requested in the first Information Document Request (IDR).

Note: IRC §7521(c) authorizes a representative to represent a taxpayer at any interview. However, the taxpayer's voluntary presence should be requested if the representative cannot provide (1) firsthand knowledge of the taxpayer's business, business practices, bookkeeping methods, accounting practices and the daily operation of the business, (2) factual and reliable responses to questions, (3) timely follow-up information for any questions that could not be answered at the time of the initial interview; or a properly authorized Form 2848, Power of Attorney (POA), or Form 8821, Tax Information Authorization from the taxpayer.

Background and Financial History

The taxpayer should provide background and financial information regarding the formation of the partnership (virtually all IRC §42 projects are owned by partnerships) and development of the project. Generally, the taxpayer should be able to explain how the partnership was organized, the terms of the partnership agreement, and when the partners made their capital contributions. The interview is also an opportunity for the taxpayer to answer any questions arising from a review of the partnership agreement, the prospectus or offering memorandum, or syndication documents.

The taxpayer should specifically discuss the development of the IRC §42 project, including:

1. The people and entities responsible for the planning and construction phases of the project, including the disclosure of related parties.
2. The services provided by the developer, the terms of the development contract, and to what extent the fee has been paid.
3. How the property was acquired; i.e., the land or the land with improvements and existing buildings. The taxpayer should also explain how costs were allocated between land, nonqualifying land improvements and depreciable residential rental property included in eligible basis.
4. The financial resources such as construction loans and permanent financing, grants, and funding from local, state or federal programs.
5. The terms of the IRC §42 credit allocation and any additional requirements imposed on the taxpayer as part of the extended use agreement.
6. How the final cost certification was prepared.

The interview is also an opportunity for the taxpayer to answer any questions arising from a review of the partnership agreement, the prospectus or offering memorandum, the credit allocation application, market study, credit allocation award, final cost certification, or depreciation schedules. For example, if the depreciable basis on the depreciation schedules is substantially different than that reflected on the final cost certification, then the taxpayer needs to explain the differences in costs.

Business Practices

The taxpayer should explain how the IRC §42 project is managed and identify the people and organizations responsible for the day-to-day operations for the project during the tax years under audit, including personnel responsible for determining whether households are income-qualified, preparing and maintaining the tenant files, receiving rents, making bank deposits, and paying expenses, and accumulating financial information used to prepare the tax return.

The taxpayer should explain to what extent the taxpayer is involved with the on-going operation of the project, physically inspects the project, and reviews the financial records. If a management company is involved, how often does the taxpayer receive updates, reports or financial summaries for the IRC §42 project? How and when does the management company notify the taxpayer of any irregularities? Does the taxpayer approve expenditures or to what extent does the taxpayer delegate responsibilities and to whom?

Does the taxpayer maintain written policies and procedures for the operation of the IRC §42 project describing how the project is intended to operate? Who opens the mail? Who receives rents from the tenants? Who deposits the rents in the bank? Who has authority to write checks? Who approves expenditures? Who reconciles bank statements? Are there periodic reviews by independent third parties?

Internal Controls

Ask the taxpayer to describe the books and records created as part of the day-to-day operation of the IRC §42 project. What are the common transactions? What books and records are maintained? Does the taxpayer review the books to ensure transactions are timely recorded and how often? Does the taxpayer separate the duties of on-site personnel? The taxpayer should explain what checks and balances are in place to establish that all income is properly accounted for from the time the rents are received by the site manager. For expenses, the taxpayer should illustrate the review and approval process for certain expenditures, especially any large or unusual expenditure.

Does the taxpayer conduct internal audits? If so, why and what were the results? Does the general partner report to a representative for the limited partners? Do the limited partners conduct their own independent audits?

Compliance with IRC §42

The taxpayer should explain what policies and procedures are in place to ensure that the project is operated in compliance with IRC §42.

Physical Maintenance: The taxpayer will need to expend resources to make repairs and maintain the project in a manner suitable for occupancy. Does the taxpayer maintain reserves for this purpose? Who decided when maintenance is needed? How often does the taxpayer conduct physical inspections of the project?

Tenant Qualifications: How does the taxpayer ensure that new tenants are income-qualified at move-in? Does the taxpayer train employees? Does the taxpayer review tenant files? Is the taxpayer using an independent management company? Is the taxpayer frequently changing management companies? Does the taxpayer conduct internal audits or reviews of the tenant files?

Tenant Files: Who prepares the files? How are they maintained? Where are they stored?

Rents: How does the taxpayer determine the maximum allowable rent? Are utility costs included in the rent, or does the tenant pay utility costs based on actual use? If the tenant pays utilities, how does the taxpayer compute the utility allowance? Does the taxpayer provide services in addition to providing housing, for which the taxpayer charges fees in addition to rent? Does the taxpayer charge pet fees? And if so, is the fee a one-time fee or a monthly fee? Does the taxpayer charge for the use of a laundry facility? Are there vending machines on site? Does the taxpayer provide cable or satellite for a fee in addition to rent? Does the taxpayer receive rent subsidies from programs such as HUD's section 8 voucher program?

Cash Flows: Generally, it is expected that the rents generated from the operation of the low-income project will be sufficient to pay on-going operating expenses and service debt. Did that expectation hold true? If not, it is important to understand why cash flows are insufficient and how the taxpayer responded. Did the taxpayer forgo maintenance or otherwise limit costs? Did the taxpayer find additional sources of revenue? Did the taxpayer stop servicing the debt, incur additional debt or find alternative financing such as a grant? Did the partners make supplementary capital contributions?

Community Service Facilities: The taxpayer should be asked whether the project includes a community service facility. If so, what services were provided, and were they provided throughout the taxable year? How did the taxpayer determine that the facility is used to provide services primarily for individuals whose income is 60 percent or less than the area median income?

Forms 8823: If the state agency filed any Forms 8823 for the low-income building with the IRS, the circumstances of the noncompliance and subsequent correction should be explained. The taxpayer should also explain how the noncompliance was accounted for when computing the allowable credit for the affected tax year.

Prior and Subsequent Year Tax Returns

If the analysis of the prior and subsequent year returns indicates that the amount of credit claimed varies from the credit claimed for the years under audit, the taxpayer should be asked to explain why.

Large, Unusual, or Questionable Items

If any item on the return is a large, unusual or questionable item (LUQ), inquiries should be made about such items during the initial interview.

Related Parties or Returns

Related returns are tax returns that have a relationship to the tax return under audit because (1) any adjustment to one return will require a corresponding adjustment to the other return to ensure consistent treatment, or (2) the returns are for entities over which the taxpayer has control and which can be manipulated to divert funds or camouflage financial transactions.

Does the taxpayer own more than one IRC §42 project? While this taxpayer may be a single asset partnership, did the general partner and limited partner form additional partnerships owning IRC §42 projects? If so, how are the books and records for the different entities kept separate? Does the same management company operate all the IRC §42 projects?

Is the project developer or management company also a general partner, or related to a general partner? The inter-relationships of the parties involved in the development and operation of an IRC §42 project can facilitate the efficient production and management of low-income housing. However, these relationships may have tax implications if transactions are not properly accounted for.

Conclusion

Interviews with the taxpayer provide an opportunity to obtain an understanding of the taxpayer's background, financial history, business operations and internal controls, and books and records in order to evaluate the accuracy of the tax return. In many cases, the dialogue with the taxpayer can help limit both the scope of the audit (issues raised) and the depth (extent of issue development).

Administrative Reminders

Expanding Audits, Project/Tracking Code: All LIHC cases should include Project Code 0670 and ERCS Tracking Code 9812. If the audit is expanded to include additional years or related taxpayers, the additional returns should also carry the LIHC project code and tracking code designation.

Form 5344, Revenue Protection: The Examination Closing Record, Form 5344, requires entries if you are reducing the amount of credit to be carried forward to a tax year you are not going to audit. Enter the amount of credit carryforward to be disallowed for Item 46. Code "L" should be entered for Item 47. See IRM 4.4.12.4.58 for an example.

Surveying LIHC Tax Returns: If you believe it is appropriate to survey an LIHC return, please fax Form 1900 to Grace Robertson, at 202-283-2485, for signature approval.

TEFRA Requirements: As LIHC property owners are almost always partnerships, and are likely to be subject to TEFRA procedural requirements, please remember to document actions taken and decisions made by completing:

- Form 12813, TEFRA Procedures
- Form 13814, TEFRA Linkage Package Checksheet
- Form 13828, Tax Matters Partner (TMP) Qualification Checksheet
- Form 13827, Tax Matters Partner (TMP) Designation Checksheet

More information is available on the TEFRA website, along with a list of TEFRA Coordinators who can help walk you through the procedures.

Subscribing to the LIHC Newsletter

The LIHC Newsletter is distributed free of charge through e-mail. If you would like to subscribe, just contact Grace at **Grace.F.Robertson@irs.gov**.

♫Grace Notes♫

Procrastination is not a good thing…true, if you wait long enough, the problem may just go away on its own, but I can honestly tell you that the anxiety of waiting it out and the likelihood that the eventual outcome won't be to my liking has usually gotten the better of me and I end up, for better or worse, trying to deal with it. And let's face it; if you know about a problem, then maybe (just maybe) you have some responsibility for creating and/or fixing it, and besides, it is one of those self-evident laws of nature: problems don't just go away.

Case in point. Almost immediately after posting the Guide for Completing Form 8823, someone pointed out that the "60" days I wrote in the example on page 18-10 really should be "90" days, shouldn't it? Well, yes. But I really didn't think it would be the only typo in the guide and I thought I'd wait a few days…then I was distracted, I forgot about it….on and on until, after no one else pointed out any other boo-boos, I thought I really should get a "round to it." But then I forgot about it, something else came up…..and then one tired day, the thought zipped through my mind at the speed of light just before I left work one evening, "I really ought to take care of that." It kept right on going, heading out beyond the confines of this universe to bounce around in an alternative dimension (probably annoying an alternative self who hasn't a clue what a "Form 8823 Guide" is…or, better yet…..she checks the Guide, Chapter 18, page 10. She's totally confused by the stray thought because she did it right in the first place and "90" days is right there on the page! But I digress.

Eventually, I focused and sent an e-mail with a follow-up date (Smart, eh?), but didn't get a response. So I sent another e-mail and wouldn't you know it? Changing something on IRS.gov isn't (as you might expect) as easy as calling someone, even if it is changing just one simple letter. But neither was it all that terrible. Just orderly. And the error has been corrected.

So, now I'm motivated. I'm going to make a list of all the other things I've got to get around to.

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