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LIHC Newsletter

Internal Revenue Service

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.

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"AMGI" and "MTSP" Income Limits

Editor's Note: This article is a follow-up to information first presented in 35th LIHC Newsletter.

Background

As part of the Housing Assistance Tax Act (HATA) of 2008, IRC §142(d)(2) was amended to add a specific "hold harmless" rule when computing the income limits used to determine whether a household is income-qualified. Specifically, any determination of *area median gross income (AMGI)* for any calendar year after 2008 is not less than the AMGI for the preceding calendar year. In other words, the AMGI may *increase* over time, but will never *decrease.*

Until the change in law, income limits were computed using HUD's determination of AMGI for Section 8. HUD annually provided tables that identified very low-income (50% of AMGI) adjusted for family size, which was used for the 20-50 minimum set-aside requirement. By multiplying the 50% AMGI by 120%, the 60% AMGI could be calculated for the 40-60 minimum set-aside requirement.

HUD is now providing two tables of AMGI determinations. The first is for use for purposes of HUD's section 8 and is subject to fluctuation over time; i.e., annual determination may *decrease* as well as increase over time.

The second table is specifically for use by owners of IRC §42 and §142(d) low-income housing projects and:

- reflects the hold harmless rules; i.e., the AMGI will never *decrease.*
- HUD provides both the 50% AMGI and the 60% AMGI, so it is not longer necessary to multiply the 50% AMGI by 120%.
- For areas where the income limits did not decrease in 2007 and 2008 because of HUD's hold harmless policy, the tables include a second set of income limits identified as "HERA Special."

And finally, to differentiate between the two tables, HUD now collectively refers to low-income housing financed under IRC §42 and §142(d) as the "Multifamily Tax Subsidy Program."

But that's not all. The National Nonmetropolitan Median Gross Income is used if:

- The project was (1) placed in service during 2006, 2007, or 2008, (2) is located in the Gulf Opportunity Zone, and (3) in a nonmetropolitan area as defined in IRC §42(d)(5)(B)(iv)(IV); i.e., the term "nonmetropolitan area" means any county (or portion thereof) which is not within a metropolitan statistical area. See IRC §1400N(c)(4).
- IRC §42(i)(8) is applicable. The IRC §42 project is located in a rural area (as defined in section 520 of the Housing Act of 1949) and the NNMGI is greater than the AMGI. IRC §42(i)(8) is not applicable if the low-income buildings are financed with tax-exempt bonds. IRC §42(g)(8) is applicable to determinations made after July 30, 2008.

To sum it all up, as of today, a taxpayer may be using MTSP income limits, HERA Special income limits, or the National Nonmetropolitan Median Gross Income to determine whether a household is income-qualified and compute the maximum gross rent that can be charged for a low-income use.

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The Here and Now Questions

The availability of so many alternative income limits raises some interesting questions.

Q1: What is "Area Median Gross Income" and how does it compare to "MTSP" income limits?

The key is appreciating the definition of "median." Really, it is just a mathematical formula for defining the center or middle of a group. In this case, it is a way of defining the "average" income for households of varying sizes in a specified area.

To compute the MTSP income limits used for IRC §42 and §142(d) purposes, HUD starts with the determination of "area median gross income," or AMGI for the Section 8 program. HUD then modifies the AMGI to satisfy the requirements imposed by Congress. Even when modified, the MTSP income limits and the HERA Special income limits are measurements of an area's median gross income, as is the National Nonmetropolitan Median Gross Income.

From a practical perspective, it means that wherever you see "area median gross income" or "AMGI" within the Code, official IRS guidance, and the Guide for Completing Form 8823, you can substitute the applicable MTSP, HERA Special, or NNMGI income limit to which the IRC §42 project is subject. HUD's "MTSP" designation doesn't make any difference.

Question #2: An income qualified tenant moved into a low-income unit in 2005, when the owner relied upon the AMGI income limits. It is a mixed low-income and market rate apartment building, so the tenant timely completed an income recertification every year, and on November 16, 2011, for the 2011 year.

The owner needs to consider whether the tenant's income has risen above 140% of the income limit for purposes of applying the Available Unit Rule under IRC §42(g)(2)(D). Which income limit should the owner use to make the comparison?

A. The Section 8 income limit used in 2005 when the household initially occupied the low-income unit,

B. The current Section 8 income limit, since Section 8 income limits were used to determine that the household was originally income qualified in 2005, or

C. The current MTSP "HERA Special" income limit."

And the answer is "C." The owner should use the *current* MTSP "HERA Special" income limits to determine whether the unit is *currently* over-income, since the project was in service during 2007 and 2008.

Question #3: A 100% low-income project is located in an area subject to the HERA Special income limits. The 15-year compliance period ended on December 31, 2010. In 2011, the buildings were purchased by a taxpayer who received a new allocation of credit for acquiring and rehabilitating the buildings for use as low-income housing. The rehabilitated buildings will be placed in service in February 2012 and the taxpayer will start claiming the credit; i.e., 2012 will be the first year of the credit period. What income limits should the taxpayer use?

A. The HERA Special income limits for FY2012, since the buildings were originally placed in service before January 1, 2009, or

B. The MTSP income limits for FY2012.

The answer is "B." For purposes of the second allocation of credit, the buildings were not in service in 2007 or 2008, so the new owner will not continue to use the HERA Special income limits. Instead, the owner will use the MTSP income limits for FY2012.

Question 4: The new owner in Question 2 has another question. Many of the low-income households occupying units at the time of the acquisition are now occupying the newly rehabilitated low-income units. Following the guidelines in the Guide for Completing Form 8823, the owner understands that these households can continue to occupy the units and the units will qualify as low-income units. As appropriate, the Available Unit Rule will also be applied. The new owner would like to know what the maximum gross rent is for these units, since the "in place" households are protected under the terms of the extended use agreement.

A. 30% of the imputed HERA Special income limits for FY2012, just as if the new owner had not acquired and rehabilitated the buildings, or

B. 30% of the imputed MTSP income limits for FY2012, since that is the maximum gross rent for new tenants.

The answer is "B." IRC §42(h)(6)(E)(ii)((II) does not allow any increase in the gross rent "*not otherwise permitted*" under IRC §42. The new allocation of credit establishes the income limits for all purposes, and the maximum gross rent limits based on the FY2012 income limits are "otherwise allowable."

The Guide for Completing Form 8823 is available at http://www.irs.gov/pub/irs-utl/lihc-form8823guide.pdf

Impact Fees & Dedicated Improvements

"Impact fees" are one-time charges imposed by a state or local government against new development or expansion of existing development to finance specific off-site capital improvements for general public use that are needed because of the new or expanded development. Taxpayers are required to pay impact fees to compensate the government entity for the financial impact of the taxpayer's development. The fees, for example, could be used to build a new school or expand a sewage system.

The question, then, is whether impact fee are includable in an IRC §42 building's eligible basis.

Rev. Rul. 2002-9, 2002-1 C.B. 614, provides specific guidance for including impact fees for determining the eligible basis. Impact fees are assessed because of a taxpayer's plans to construct a new residential building and are treated as indirect costs under IRC §263A because they directly benefit, and are incurred by reason of, a taxpayer's production activity. In accordance with Treas. Reg. §1.263A-1(f), the taxpayer must allocate the impact fees to the property produced. Because impact fees are calculated based upon the characteristics of the building and the impact fees are generally refundable if the building is not constructed as planned, the fees are 100% allocable to the building.

Similar to the treatment of impact fees, costs to construct dedicated infrastructure improvements are indirect costs within the meaning of Treas. Reg. §1.263A-1(e)(3)(i) for purposes of IRC §263A and are capitalizable to the property produced because the costs directly benefit, or are incurred by reason of, the construction of the project. Infrastructure, for example, includes streets, curbs, sidewalks, and storm water drainage required by the local government and constructed according to the local government's specifications. To qualify, the improvements must be dedicated to the local government for public use after completion. Upon acceptance of the dedication, the local government will own and maintain the infrastructure assets. For an example, refer to PLR 200916007.

HUD Releases FY2012 Income Limits

On December 1, 2011, HUD released the FY2012 MTSP income limits. The effective date is December 1, 2011. However, Rev. Rul. 94-57 provides that taxpayers may rely on the income limits published by HUD until 45 days after HUD releases a new list of income limits, , or until HUD's effective date for the new list, whichever is later. This year, since the income limits were released and effective on the same day, taxpayers may rely on the 2011 income limits until January 14th, 2012.

The new income limits are available on-line at the address in the box.

Not only are all the income limits available in tables and Excel files, but HUD has developed a Income Documentation System (IDS) that will provide the income limits by location.

To use the system, simply identify the state and county in which the project is located, and the program will provide the 50% and 60% income limits, and if applicable, the "HERA Special" income limits. The system also includes income limits for home rule cities such as Washington, D.C. and U.S. territories.

Equally important, the program provides income limits based on when the buildings were placed in service. HUD refers to this categorization of buildings as the "vintage" and is necessary for correctly applying the hold harmless rules.

FY2012 Income Limits are available at

www.huduser.org/portal/datasets/mtsp.html

The results can be printed out and used as documentation of the income limits relied on to determine whether households are income qualified and when computing the maximum rent that can be charged.

Audit Technique for Examiners

The IDS is also helpful for IRS audit purposes. HUD maintains historical MTSP data back to FY2009, when all the new rules for income limits first took effect.

Critical information for determining the income limits are identified on Form 8609.

- The building's location is identified in Box A.
- The date the building was placed in service is documented on line 5.
- The taxpayer's minimum set-aside election is documented on line 10c.

Generally, under IRC §42(g)(2), the maximum rent that can be charged for a unit is based on the number of bedrooms and as if there are 1.5 persons in the household for each separate bedroom. Examiners will still need the taxpayer being audited to explain how the rent charged was computed, considering all the rules in addition to "generally."

Annual Certification to the State Housing Agency

As if there isn't enough list checking at this time of year, just a reminder that the annual certification to the state housing agency is coming up soon.

Under Treas. Reg. §1.42-5(c)(1), taxpayers are required to certify to the state agency that allocated the credit at least annually that, for the preceding 12-month period, that the *project* was operated in compliance with IRC §42 requirements. Most state agencies have protocols in place so that the "annual period" is the calendar year with due dates for submission.

The regulation outlines twelve specific requirements. So, here's the "Reader's Digest" condensed version of the list. You'll need to refer to the regulation for details and Code references.

1. The project met the minimum set-aside as elected by the taxpayer. If applicable, the project met the 15-40 test or the "deep rent skewed" test.
2. There was no change in the applicable fraction of any building in the project, of if there was, the certification includes an explanation.
3. An annual income certification and documentation to support the certification was received from each low-income tenant. Keep in mind that "recertifications" are not require for 100% low-income projects, but the state agency may require them.
4. All low-income units were rent-restricted.
5. All low-income units were for use by the general public.
6. The buildings and low-income units were suitable for occupancy.
7. There was no change in the eligible basis of any building in the project, or an explanation is included with the certification for the change.
8. Tenant facilities were provided on a comparable basis without charge to all tenants in the buildings,
9. Reasonable attempts were made to rent low-income units before renting units to tenants not having a qualifying income; i.e., compliance with the Vacant Unit Rule.
10. If the income of tenants of a low-income unit in the building increased above the limit allowed, the next available unit of comparable or smaller size in the building was or will be rented to tenants having a qualifying income; i.e., compliance with the Available Unit Rule.
11. An extended use commitment was in effect. This commitment is also referred to as the extended use agreement or land use restriction agreement (LURA).
12. All low-income units in the project used on a nontransient basis, unless an exception applies.

For more information about the filing of Form 8823,

visit www.irs.gov

http://www.irs.gov/pub/irs-utl/lihc-form8823guide.pdf

Even though the certification is made to the state agency, failure to complete the annual certification is reportable to the IRS on Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition, line 11d. Some of the common problems reported to the IRS are:

1. The certification is incomplete, e.g., the taxpayer did not certify compliance with a specific IRC §42 requirement.
2. The certification isn't signed, which really means it isn't a "certification" at all.
3. Most state agencies are very forgiving about late certifications, but at some point, usually after sending reminders to the taxpayer, the state agency will report that the certification has not been received, sometimes for multiple years.

Which brings us to another question. Who is responsible for making the certification? As an industry practice, many IRC §42 projects are operated by management companies acting as agents of the taxpayer, and by agreement between the parties, the agent becomes responsible for submitting the certification. For IRC §42 purposes, however, the regulation is quite clear. Treas. Reg. §1.42-5(g) explains that "compliance with the requirements of section 42 is the responsibility of the owner of the building for which the credit is allowable" That includes making the annual certification to the state agency.

So how does the IRS view the annual certification? The certification is documentation prepared contemporaneously to the occurrence of the events, which is, in the absence of evidence to the contrary, credible evidence of compliance with specific IRC §42 requirements, even if "self-prepared."

If audited, the certification can eliminate significantly detailed analysis of a taxpayer's records. But what happens if a taxpayer didn't make the certification?

First, most of the items on the list can be documented with "paperwork" the taxpayer should have, or can possibly be reconstructed if need be. Keep in mind that audits are generally conducted two to three years after the end of the tax year under audit and some "paperwork" is, quite frankly, onerous to reconstruct.

Take for example, the Available Unit Rule. A taxpayer must document compliance by identifying all over-income units and the size of the units every time a unit is rented to a nonqualifying tenant. The rule is specifically applicable to mixed-use projects where the owner is renting units at market rate. If the issue is raised for an owner of a 100% low-income project where income recertifications are not required, the burden of reconstructing tenant files may be impossible. See Newsletter #32 for additional discussion.

The real issue with after-the-fact documentation is that it is often incomplete and lacks credibility. In some cases, it is virtually impossible to provide satisfying evidence of compliance.

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Administrative Procedures

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.

Revenue Protection:
Form 5344, Examination Closing Record, 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 202-283-7008, for signature approval.

TEFRA Requirements:
As IRC § 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.

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For example, as part of the annual certifications, taxpayers certify that the project was suitable for occupancy. In the absence of the self-certification, an IRS examiner may ask if the project was inspected by the state agency as part of its compliance monitoring responsibilities, which would provide *very* credible evidence. But what if the state agency didn't inspect the project? What then? Maybe the project was physically reviewed by HUD for one of its programs, or maybe by a local government agency looked at it. But if not, then there is nothing contemporaneously prepared—not a third-party, independent review or self-certification—to evidence that the project was suitable for occupancy. What happens then? Doubt.

Every case is different, but a failure to certify raises questions about the taxpayer's on-going compliance with the requirements for operating the IRC §42 project. Most certainly, an examiner will consider expanding the audit to include a more in-depth analysis. And if so, providing retroactively prepared documentation will most likely be difficult, if not impossible, and will not have the same credibility as evidence contemporaneously prepared at the time that the event occurred.

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♫ Grace Notes ♫

It's time to thing about my favorite things, which is always a bit of a problem since attempting to rank things I like in priority order baffles me into paralysis. Frankly, the only "favorites" I find useful are bookmarked websites on my computer's browser. But I'll try.

- Whiskers on kittens, particularly those belonging to Hannah, the big white cat with red markings, and Olivia the Siamese.
- Learning new things. Hence this "published" newsletter.
- Words like "onerous" and "contemporaneous." !

And friends, in no particularly order of priority, including, but certainly not limited to:

♫ Friends (all of them) who continue to put up with me, bless their hearts!

♫ New friends who serendipitously (another favorite word) crossed my path this year. My Christmas list is growing and the Post Office is saved!

♫ Old friends who send me a Christmas card first. I'd be first but it's a long commute around the beltway; I have no other plausible excuse!

♫ Older friends that have been friends for so long that I can't remember when we weren't friends. No explanation needed.

♫ Lost friends found this year. Thank goodness for the internet and our total lack of privacy. Well, at least if your name isn't common and you're listed in the white pages.

♫ Friends lost this year. I can't send a Christmas card but they remain safely embraced in my heart.

♫ And not to carry this way too far, childhood friends.

Especially (another favorite word) one little girl who moved away after second grade. I missed her tremendously and for my birthday the following year, my mother arranged for the two of us to see The Sound of Music together. It had just been released and was playing in one of the bigger, fancier, old-time theatres in uptown Salt Lake City ("downtown" Salt Lake was two blocks south). We felt so grown up in our fancy dresses, going to the huge theatre all by ourselves. We had a wonderful time together that I'll never forget. Little did we know that "My Favorite Things" would become a holiday classic. Just can't help thinking of my friend whenever I hear that song...

...but I've digressed. I've got oodles more favorite things on my list, but I've got a couple of "naughty and/or nice" lists to attend to right now...and besides, you're working on your own list of favorite things.

Happy Holidays!

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