LIHC Newsletter

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The LIHC Newsletter provides a forum for networking and sharing information bout 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 content of this newsletter should not be used or cited as authority for setting or sustaining a technical position.

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"Relying" on New Income Limits

As noted in the last newsletter, HUD released the FY2012 MTSP income limits on December 1, 2011, and the effective date is also December 1, 2011. For purposes of IRC §42, 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 45-day implementation period hasn't been much of an issue in the past because the new limits remained the same or increased and it was clearly to the taxpayer's advantage to adopt the new income limits as quickly as possible. Where the income limits decreased this year, different issues become apparent and we're left wondering to what extent taxpayers can really "rely" on the outdated income limits during the implementation period.

The straightforward answer is that taxpayers can rely on the outdated income limits for all purposes, and may choose which income limits to use (outdated or new) based on which provides the greater tax benefit.

Three examples are presented here.

Income Certifications

A taxpayer placed a new low-income building in service in July of 2011 and started renting units using the 2011income limits to determine whether households are income-qualified. 2012 will be the first year of the credit period. The 2012 income limits are lower than the 2011 income limits.

- All of the tenants determined to be income-qualified using the 2011 income limits before the beginning of the credit period on January 1, 2012, continue to be qualified low-income households. Further, for purposes of "testing" income at the beginning of the credit period under Rev. Proc. 2003-82, the taxpayer may rely on the 2011 income limits to determine whether the Available Unit Rule is applicable.
- The owner may continue to qualify new tenants using the 2011 income limits, as long as the effective date for the income certification is before or on January 14th, 2012. The effective date is the date the tenant actually moves into the unit.

Gross Rent Floor

Under IRC §42(g)(2)(A), a unit qualifies as a low-income unit when the gross rent does not exceed 30% of the

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"Relying" on New Income Limits

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imputed income limit unit under IRC §42(g)(2)(C). IRC §42(g)(2)(A) includes a rent "floor" so that the income limits used to compute the rent are never less than the income limits used to compute the rents "for the earliest period the building was included in the determination of whether the project is a qualified low-income housing project." In English, the rents are never going to be lower than the maximum gross rent for the first year of the credit period.

But what are the rent limits for the first year? Under Rev. Proc. 94-57:

- If the taxpayer received an allocation of credit under IRC §42(h)(1), the IRS will treat the gross rent floor as taking effect on the date the state agency initially allocated the housing credit to the building.
- For a bond-financed building described in IRC §42(h)(4), the IRS will treat the gross rent floor as taking effect on the date the state agency initially issues a determination letter to the building.

However, in either case, the IRS will treat the gross rent floor as taking effect on a building's placed in service date if the building owner designates that date as the date on which the gross rent floor will take effect for the building. An owner must make this designation to use the placed in service date and inform the state agency that made the allocation to the building no later than the date on which the building is placed in service.

What happens if a taxpayer places a low-income building in service between December 1, 2011 and January 14, 2012 (inclusive), designates the placed-in-service date to establish the rent floor, and the 2012 income limits are lower than the 2011 income limits? Clearly, it is to the taxpayer's advantage to use the 2011 income limits to establish a higher gross rent floor, but can the taxpayer rely on the 2011 income limits for this purpose?

The straightforward answer is that taxpayers can rely on the outdated income limits for all purposes, and may choose which income limits to use (outdated or new) based on which provides the greater tax benefit.

Yes. The taxpayer may rely on the 2011 income limits up to and including January 14, 2012, for all purposes.

Designation as Rural Area

The final example involves low-income housing projects located in rural areas. The National Non-metropolitan Median Gross Income (NNMGI) is used instead of HUD's MTSP income limits if:

- IRC §1400N(c)(4), Special Rule for Applying Income Tests, is applicable. The IRC §42 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.
- 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.

What happens if the location loses it's designation as a "rural" area?

- For purposes of determining whether a household is income-qualified, the taxpayer can continue to use the NNMGI as long as the effective date of the income certification is before January 15, 2012.
- For purposes of determining whether a household is income-qualified, the taxpayer must start using HUD's MTSP income limits for certifications effective after January 14, 2012.

The gross rent floor established using the NNMGI remains in place and can be relied upon, even though the taxpayer is now using the MTSP income limits.

Suitable for Occupancy: Infestations

No one, under any circumstances, should feel compelled to inspect a unit, building, or site when the situation is dangerous or the life or health of the person conducting the inspection is threatened in any way.

Under IRC §42(i)(3), a "low-income" unit must be rent restricted and the household occupying the unit must be income-qualified. However, even if these two requirements are met, a unit is not treated as a low-income unit unless the unit is suitable for occupancy. The Code provides that the "suitability" of a unit for occupancy is determined under regulations (Treas. Reg. §1.42-5) taking into account local health, safety, and building codes.

In CCA 201042025, Chief Counsel clarified two issues:

- A violation of the HUD physical condition standard alone is sufficient for a violation of IRC §42(i)(3)(B).
- A taxpayer, in response to the IRS finding a violation, may raise an affirmative defense by proving that local health, safety, or building codes address the specific point in question, and after application of the facts, local law reaches a taxpayer favorable result where as the HUD standard does not reach a taxpayer favorable result. Under these circumstances, the local law would control as respects the violation itself. That is, the local law would be the standard against which "suitability for occupancy" would be evaluated.

As a result, for IRS purposes, we look to HUD's Uniform Physical Condition Standards to determine whether low-income units, buildings and sites are suitable for occupancy.

Uniform Physical Condition Standards (UPCS)

The UPCS (24 CFR §5.703) require housing to be decent, safe, sanitary and in good repair. The major areas of consideration include the site, building exterior, building systems, dwelling units, common areas, and health and safety concerns. The description of "Health and Safety Concerns" reads:

> "…All areas and components of the housing must be free of health and safety hazards. These areas include, but are not limited to, air quality, electrical hazards, elevators, emergency/fire exits, flammable materials, garbage and debris, handrail hazards, infestation and lead based paint…"

HUD has also provided a Dictionary of Deficiency Definitions, which describes infestations for inspection purposes as:

> "You see evidence of infestation of insects -including roaches and ants- throughout a unit or room, especially in food preparation and storage areas."

Bed Bugs

Bedbugs are small wingless insects that feed solely on the blood of warm-blooded animals (including humans). They are also a growing infestation problem. Historically, bed bugs were commonly found in homes, dormitories, hotels and motels, and on military bases. In recent years, infestations are spreading to nonresidential public and commercial buildings. The Center for Disease Control has stated that bed bugs are not known to transmit disease, but it is recognized that bed bugs can cause a variety of negative physical health, mental health and economic consequences.

Controlling bed bugs poses unique challenges. Not only is it a complex environment, but early detection is unlikely and visual inspections are difficult. Bed bugs may be dispersed over large areas, so identifying the point of introduction may be problematic and reintroduction is always possible.

Physical Inspections and Reporting Noncompliance

Treas. Reg. §1.42-5 requires state housing agencies to conduct on-site physical inspections for all buildings in the project by the end of the second calendar year following the year the last building in the project is placed in service and at least once every 3 years thereafter. In addition to the buildings, at least 20% of the low-income units must be inspected.
Treas. Reg. §1.42-5 also required state agencies to report noncompliance (including bed bug infestations) to the IRS on Form 8823, Low-Income Housing Agencies Report of Noncompliance or Building Disposition.

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Bedbugs…...

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Questions and Answers

With regard to possible insect infestations, including bed bugs:

1. What should a state agency do if inspecting a building or individual unit poses a threat to the safety of the person doing the inspection?

   No one, under *any* circumstances, should feel compelled to inspect a unit, building, or site when the situation is dangerous or the life or health of the person conducting the inspection is threaten in *any* way.

   Further, if the physical condition is unsafe for the person conducting the inspection, then the unit/building/site is unsafe for low-income households occupying the premises and the unit/building/site should be reported to the IRS as unsuitable for occupancy.

2. Since bed bug infestations are difficult to identify, when should noncompliance be reported?

   Like all noncompliance issues, bed bug infestations should be reported to the IRS if (1) the infestation was discovered through inspection or review, or (2) some other manner; i.e., credible information received from a reliable source and includes reasonable grounds for being believed. Note: If, after filing a Form 8823, it is determined that the building was *never* infested with bed bugs, then an amended Form 8823 should be filed to rescind the original filing. See Newsletter #44 for details.

3. Since bed bug infestations are difficult to eradicate, when should a unit or building be considered back in compliance?

   The noncompliance is considered corrected when the owner demonstrates compliance with local health, safety, or building codes specific to insect infestations and eradication.

Dispositions in the 11th Year of the 15-Year Compliance Period: Allocating the Credit Between the Buyer and Seller

Under IRC §42(f)(1), the *credit* period is defined as the period of ten *taxable years* beginning with the taxable year in which the building is placed in service, or at the election of the taxpayer, the succeeding taxable year. Since the building will most likely be placed in service sometime during the taxable year, there is a special rule for computing the Applicable Fraction to account for when the units are first occupied by qualified low-income tenants. Under IRC §42(f)(2), the applicable fractions for each month of the taxable year that the units were placed in service are summed and divided by 12. Effectively, the Applicable Fraction for the first *taxable year* of the credit period is an "averaged" Applicable Fraction as if the building had been in service the entire *taxable year.* Any credit not allowable for the first year of the credit period is allowable in the first taxable year after the credit period, or more clearly, the 11th year of the 15-year compliance.

The question, then, is how to treat the credit allowable in year 11 of the compliance period, if there is a disposition of the building during the year.

Consider a simple example for a calendar year taxpayer: A low-income building with one low-income unit (single family home) received an allocation of credit equal to $10,000. The home is placed in service in May of 2001 and is first occupied by a qualifying tenant in July. 2001 is the first year of the credit period and the taxpayer computes the Applicable Fraction using the special rule. For July through December the Applicable Fraction is 100%: 6 x 100% = 600%, which is then divided by 12, which is 50%. The taxpayer is entitled to claim $5,000 in 2001 and if the taxpayer remains compliant with IRC §42 re-

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quirements, the taxpayer will be able to claim $5,000 for the 2011 taxable year.

However, on October 1, 2011, during the 11th year of the 15-year compliance period, the taxpayer disposes of the building. Under IRC §42(f)(4), the credit is allocated between the seller and buyer based on the number of days during such year that each party owned the building. Under Rev. Rul. 91-38, the credit can be allocated based on the number of months each party has ownership. How should the credit be allocated?

Option A:

Since the credit claimed for 2001 is associated with providing housing from July to December, the 11th year credit is associated with providing housing from January through June 2011. The entire $5,000 credit should be allocated to the seller.

Option B:

Since the buyer owned the building at the end of the 11th year of the compliance period, the entire credit for the 11th year is allocated to the buyer.

Option C:

If the building is compliant with IRC §42 requirements at the end of the 11th year of the compliance period, the credit allocated to the seller is 9/12 x $5,000= $3,750 and the buyer would get $1,250, computed as 3/12 x $5,000.

Options A and B are incorrect. The 11th year credit isn't associated with any particular months of the taxable year, nor is the allowable credit associated with the party owning the building at the end of the 11th year of the compliance period because there is a special allocation rule under IRC §42(f)(4) applicable to all years that the credit is allowable.

Option C is the correct treatment as long as the building is compliant with IRC §42 requirements. If, at the end of the 2011 taxable year, the building is not in compliance, then no credit is allowable to either the seller or the buyer to the extent of the noncompliance, and the seller is subject to the IRC §42(j) recapture provisions. The recapture rate for the 11th year is .333.

LIHC Newsletter #47 Corrections

There were three errors in the last newsletter that need to be corrected.

- Even though it is labeled #44, the last newsletter issued in December 2011 really was #47.
- In Question #4 on page 2, there is a reference to the "new owner in Question 2." That should be the new owner in Question 3.
- The phone number at the end of "Grace Notes" is incorrect. It should be (202) 283-2516. My sincere apologies to those of you who tried to call me.

Administrative Procedures

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

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 IRC 4.4.12.4.58 for an example.

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

TEFRA Requirements:
As IRC §42 project 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) Qualifications Checksheet
- Form 13827, Tax Matter Partner (TMP) Designation Checksheet

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Guide for Completing Form 8823

The "Guide" is available on the IRS website. There's a searchable html version and a downloadable pdf file. On the IRS website, www.irs.gov, enter "ATG" in the search engine. Select the first link on the list of results for "Audit Technique Guides." Then select "L" from the alphabet list and the Guide will be listed as "Low-Income Housing Credit-Guide for Completing Form 8823." Clicking on the title will lead you to the html version and the link to the right of the title will link you to the pdf file.

♫ Grace Notes ♫

The last newsletter was prepared in a new pdf format and I asked you to let me know how you like it. Some of you responded almost immediately, emphatically voting to keep the new look; I suspect that anything in Adobe pdf is preferable to anything is Word for these subscribers. More responses were sent over the next week or so, and included considered rationales and suggestions for improvements. Even so, the over-whelming response has been that the new pdf format is preferred.

So, in true democratic fashion, the majority will prevail and I'll be using the Adobe pdf format from now on. However, the reasons why some of you prefer the Adobe pdf format are the exact same reasons why others prefer the Word format. So, for those of you in the minority, who prefer the Word format unencumbered by the preferences of the majority, please send me an e-mail letting me know you want the Word version. Otherwise, you'll just keep getting the pdf format.

And just in case you're thinking, "Gee, isn't Grace being nice?", I want to dispel that fleeting thought right now…I'm really not. I write the newsletter in the Word format (easier for me) and then "publish" in the Adobe pdf format, so it is no extra burden for me to send the Word-formatted newsletter to those who want it. Oh…one last thought…*please* don't ask to receive both versions, which would require me to keep duplicate distribution lists.

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