Examination Specialization and Technical Guidance's

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.

New Income Limits for 2009: *Really* New Income Limits

As usual, HUD has released the 2009 income limits, with a March 19, 2009, effective date. Owners of IRC §42 and IRC §142(d) housing projects have until May 3, 2009 (45 days), to implement the new limits and rents. However, the new income limits are particularly important this year as they reflect changes in law enacted way back in July of 2008.

New Law Incorporates "Hold Harmless" Policy

Section 3009 of the Housing Assistance Tax Act (HATA) amended IRC §142(d)(2) to add a new subparagraph E, which reads:

(E) Hold harmless for reductions in area median gross income.

(i) In general. Any determination of area median gross income under subparagraph (B) with respect to any project for any calendar year after 2008 shall not be less than the area median gross income determined under such subparagraph with respect to such project for the calendar year preceding the calendar year for which such determination is made.

(ii) Special rule for certain census changes. In the case of a HUD hold harmless impacted project, the area median gross income with respect to such project for any calendar year after 2008 (hereafter in this clause referred to as the current calendar year) shall be the greater of the amount determined without regard to this clause or the sum of--

(I) the area median gross income determined under the HUD hold harmless policy with respect to such project for calendar year 2008, plus

(II) any increase in the area median gross income determined under subparagraph (B) (determined without regard to the HUD hold harmless policy and this subparagraph) with respect to such project for the current calendar year over the area median gross income (as so determined) with respect to such project for calendar year 2008.

(iii) HUD hold harmless policy. The term "HUD hold harmless policy" means the regulations under which a policy similar to the rules of clause (i) applied to prevent a change in the method of determining area median gross income from resulting in a reduction in the area median gross income determined with respect to certain projects in calendar years 2007 and 2008.

(iv) HUD hold harmless impacted project. The term "HUD hold harmless impacted project" means any project with respect to which area median gross income was determined under subparagraph (B) for calendar year 2007 or 2008 if such determination would have been less but for the HUD hold harmless policy.

Keep in mind that IRC §142(d)(2) is cross referenced in IRC §42(g)(4) and is equally applicable to qualified low-income projects under IRC §42.

The General "Hold Harmless" Rule

IRC §142(d)(2)(E)(i) provides the general rule:

- Any determination of area median gross income (AMGI) under subparagraph (B),
- For any calendar year after 2008
- Not less than the AMGI for the preceding calendar year.

Applying the "hold harmless" policy seems straightforward. For both qualified residential rental properties under IRC §142 and low-income housing under IRC §42, an initial AMGI is determined with respect to a project and the AMGI for any given year going forward from the date of initial determination will never be less than the AMGI for the year before. As a result, Congress has providing owners with some stability and

predictability when forecasting (1) the income limits used to determine whether a household is income-qualified, and (2) the maximum rents that can be charged for low-income units.

Implementing the Hold-Harmless Provision

In 2007 and 2008, HUD modified the methodology used to calculate AMGI to include additional data sources. In some areas, the change in methodology resulted in a significant decrease in the area's median gross income. As a result, HUD used a "hold harmless" policy to keep the AMGI at the existing level (the "HUD hold harmless policy"). This is the hold harmless policy referred to in IRC §142(d)(2)(E)(iii) and projects for which the AMGI was not decreased in 2007 or 2008 because of this policy are "HUD hold harmless impacted projects" under IRC §142(d)(2)(E)(iv).

For "HUD hold harmless impacted projects," the AMGI is the greater of:

1. AMGI determined using the general rule in IRC §142(d)(2)(E)(i) or,

2. the sum of the AMGI under the HUD hold harmless policy for 2008 plus any increase in AMGI after 2008.

Practical Application

Up until now, Rev. Rul. 89-24 provided guidance for computing the income limits and we relied upon HUD's determination of AMGI as the starting point. HUD annually provided updated 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.

From now on, HUD is providing two tables, one for Section 8 and other HUD programs and one for IRC §§ 42 and 142(d) housing projects as described below.

Section 8 and Other HUD Housing Programs

HUD will continue providing the AMGI as it has in the past for purposes of Section 8 and other HUD programs. Significantly, beginning with income limits in 2010, HUD will no longer apply a hold harmless policy and the limits will fluctuate up and down over time with changing economic conditions in the area.

Multifamily Tax Subsidy Projects

HUD now refers to qualified residential rental projects under IRC §142(d) and qualified low-income housing projects under IRC §42 collectively as "Multifamily Tax Subsidy Projects" (MTSP). Starting this year, HUD is providing a separate table with income limits specifically calculated for MTSPs. For 2009, the income limits for MTSPs are based on the Section 8 limits that incorporate the HUD hold harmless policy.

The tables are in the same format that has always been used. The column down the left-hand side identifies the state and area within each state. From left to right, the columns identify the income limits based on household size (1 to 8 persons).

The tables are different in three respects:

1. The tables identify the income limits at the 50% and 60% AMGI levels needed to satisfy the minimum set-aside requirements under IRC §142(d)(1) or IRC §42(g)(1). As a result, the instructions in Rev. Rul. 89-24 to compute 60% AMGI are no longer needed.

2. The table for 2009 includes the hold harmless requirement under IRC §142(d)(2)(E)(i).

3. In those 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 50%" and "HERA Special 60%." FYI: The IRS refers to tax act of July 2008 as the Housing Assistance Tax Act of 2008 (HATA) and HUD refers to it as the "Housing and Economic Recovery Act of 2008 (HERA).

Desperately Asked Questions (DAQs)

Q1: I own an IRC §42 project. How do I know if the project is a "HUD hold harmless impacted project?"

A1: You must meet two requirements:

1. You relied on the income limits provided by HUD to determine the income limits applicable to your project and determined whether households were income qualified based on those income limits (adjusted for family size). If your project was in service, or placed in service during 2007 or 2008, you relied on the income limits provided by HUD. Conversely,

if your project was not placed in service until after December 31, 2008, you could not have relied on the income limits provided by HUD in 2007 or 2008.

2. The MTSP tables for 2009 indicate whether the area in which your project is located is an area affected by HUD's hold harmless policy in 2007 or 2008; i.e., the HERA Special 50% and 60% income limits are identified in the table for your project's location.

Q2: The Hold Harmless rule is applied at the project level. How do I identify my project?

A2: Under IRC §42(g)(3)(D), every low-income building is a separate project unless the owner elects to include the building in a multi-building project. The election is documented on Form 8609, line 8b. In addition to checking the appropriate box, the owner must also provide a statement identifying all the buildings in the project when submitting the Form 8609 to the IRS to complete the First Year Certification under IRC 42(l)(1).

As a practical matter, if your project was placed in service in 2007 or 2008, you might not yet have completed the First Year Certification. You can still treat all the buildings as part of a multi-building project but be sure to complete the First Year Certification as soon as possible with elections that reflect your actions prior to the certification.

Q3: My project is located in an area impacted by HUD's hold harmless policy, but what if some of the low-income buildings in my project were placed in service in 2008 and some will be placed in service in 2009?

A3: If at least one building in the project was placed in service during 2007 or 2008, then all the buildings in the project are subject to the HERA Special 50% and 60% income limits. As a result, the income limits used to determine whether a household is income-qualified and calculate the maximum gross rent will be the same for all the buildings in the project.

Q4: I bought an existing building in 2008 with tenants in place which I am rehabilitating. I plan to place the rehabilitation in service during 2009. I relied upon the Rev. Proc. 2003-82 safe harbor to rent low-income units to income-qualified tenants in 2008, before the beginning of the credit period. The HUD tables indicate that the building is located in an area impacted by the HUD hold harmless policy in 2008, but my rehabilitation wasn't placed in service until 2009. Is the project subject to the HERA special income limits?

A4: Yes. Even though the 10-year credit period had not yet begun, you relied upon the HUD income limits in 2008 to determine the income limits and whether households were income-qualified.

Q5: My project is subject to IRC §1400N(c)(4) because the IRC §42 project was placed in service during 2007, is located in the Gulf Opportunity Zone, and is in a nonmetropolitan area (as defined in IRC §42(d)(5)(B)(iv)(IV)). As a result, I have been using the National Nonmetropolitan Median Gross Income (NNMGI) to determine income limits. Is my project subject to the HERA special income limits?

A5: No, you will continue to use the NNMGI to determine the income limits.

Q6: My IRC §42 project is located in a rural area (as defined in section 520 of the Housing Act of 1949) and has been in service since 2004. Under IRC §42(i)(8), for determinations made after July 30, 2008, the income limit is the greater of the AMGI or the NNMGI. The new HUD tables for 2009 indicate that the area was impacted by HUD's hold harmless policy. What should I do?

A6: Since you relied upon the HUD income limits in 2007 and 2008, you will now use the greater of the HERA special income limits or the NNMGI. CAUTION: IRC §42(i)(8) is not applicable to projects that do not have an allocation of credit under IRC §42(h)(1), but instead are financed with tax-exempt private activity bonds and credits associated with the §146 volume cap.

Q7: I placed my IRC §42 project in service in 2008, but did not begin the 10-year credit period until 2009. The project is located in an area impacted by the HUD hold harmless policy. Should I use the HERA special income limits?

A7: Yes, because you placed the building in service no later than 2008 and the income limits for the building were determined in 2008. Notice 88-116 explains that the placed-in-service date for a new or existing building used as residential rental property is the date on which the building is ready and available for its specifically assigned function, i.e., the date on which the first unit in the building is certified as

being suitable for occupancy in accordance with state or local law. Presumably, if the building and units are ready and available for occupancy in 2008, you would rely on HUD's income limits for 2008 to determine whether households are income-qualified and could rely upon the Rev. Proc. 2003-82 safe harbor to rent low-income units to income-qualified tenants before the beginning of the credit.

Q8: My low-income housing development was built in three phases; the first phase was placed in service in 2007, the second phase in 2008, and the third phase will be placed in service in September of 2009. Technically, each phase is identified as a separate project on the Forms 8609, but physically the development is seamless; the buildings in all three projects are identical and you can move freely among all the buildings. So, the first two phases are subject to the HERA special income limits, and I will use the regular MTSP income limits for the third project?

A8: You are correct. CAUTION: Be sure you document when the buildings were placed in service and keep the documentation secured.

Q9: As part of my credit allocation, I agreed to provide a specific number of units for households with income at or below 30% of the AMGI. My project is located in an area impacted by HUD's hold harmless policy in 2007 and 2008. How do I compute the 30% AMGI income limit?

A9: The state housing agencies have authority to impose addition restrictions upon an IRC §42 credit allocation. These restrictions or requirements are recorded as part of the extended use agreement and are enforceable by state housing agencies under state law. The state housing agency should provide you with instructions.

Q10: Has there been any change in the way we compute the maximum gross rent?

A10: No, under IRC §42(g)(2)(C) the gross rent is based on imputed income limits which would apply if the number of individuals occupying the unit were 1.5 individuals for each separate bedroom.

For example, to compute the rent for a 1-bedroom unit you would add the one person income limit and the two-person income limit together and divide by two, multiply by 30% and then divide by 12 to identify the monthly maximum gross rent.

Q11: My 100% LIHC project was placed in service in 2006 and is financed with a federally-subsidized loan from HUD. To receive the higher 70-percent credit, I am renting at least 40% of the units to households with income at or below 50% AMGI. I understand that I continue to be subject to this rule, but which income limits do I use to determine the 50% AMGI income limit? Do I use HUD income limits for Section 8 or the "HERA Special" MTSP income limits?

A11: The MTSP income limits should be used to determine the 50% AMGI used for the 40-50 rule under former IRC §42(i)(2)(E). Since you relied upon HUD's income limits in 2007 and 2008, you should the HERA Special Income Limits.

Q12: 2007 was the 15th year of the compliance period for my low-income building and I am now operating under the terms of the extended use agreement (IRC §42(h)(6)). Am I subject to the MTSP income limits?

A12: Yes, the MTSP "HERA Special" income limits are applicable to your project, even after the end of the 15-year compliance period during which you are subject to credit recapture. However, if you (or a subsequent owner) receive a new allocation of credit and begin a new credit period sometime in the future, you would use the normal MTSP income limits since you did not rely upon HUD's income limits in either 2007 or 2008.

Conclusion (Editor's Note)

Whenever I've worked my way through one of these entangled IRC §42 requirements, I think of Judge Joel Gerber, who ruled in the Tax Court case Bentley Court v. Commissioner. In his written decision, he referred to IRC §42 as "detailed and complex." Yeah, right…I don't know whether to laugh or cry.

IRC §42 Low-Income Buildings Damaged by Casualty Events: Chief Counsel Advisory 200912012

Chief Counsel has provided guidance for three issues related to IRC §42 properties damaged by casualty events. The Chief Counsel Advisory (CCA) was issued February 20, 2009.

Legal Authority

IRC 42(j)(4)(E) only provides relief from the recapture provisions, and then only to the extent that the building is restored by reconstruction or

replacement within a reasonable time, which is generally two years. It does not provide authority for claiming the credit during the time that a low-income building is being restored.

This has been a bit of a confusing point because under Rev. Proc. 2007-54, which addresses casualty events in areas declared major disasters under the Stafford Act, a taxpayer can continue to claim the credit during the construction period. The authority for this determination is Treas. Reg. 1.42-13(a)

Failure to Restore Building

If an owner tries, but fails to restore a low-income building within a reasonable period of time, which year is the recapture year?

The CCA explains that the year of recapture is the year of the casualty event. Further, if the casualty event is in an area designated a federal disaster, the credits claimed for the year the disaster occurred and during the subsequent reconstruction period are disallowed.

If the statute of limitation is closed for the recapture year, then the taxpayer's first open taxable year in the 15-year compliance period is treated as the year of the taxpayer's reduction in qualified basis. See Bentley Court II Limited Partnership v. Commissioner, T.C. Memo. 2006-113 (2006), which was discussed in Newsletter #21.

Casualty Event & Restoration in the Same Year

If a building is damaged by a casualty event and fully restored within the same taxable year, then there is no recapture or loss of credits *if* the units were restored within a reasonable period *and*:

1. Each unit is occupied by low-income tenants by December 31st of the year, *or*
2. The owner initiated continual and verifiable measures to rent restored vacant units to low-income tenants immediately upon restoration of the building. See Q&A #9, Rev. Rul. 2004-82, 2004-2 C.B. 350, for discussion of reasonable attempts to rent vacant units.

Generally, the credit is determined at the close of the taxable year under IRC §42(c)(1). Credit is determined on a monthly basis only for the first year of the credit period under IRC §42(f)(2)(A), and for additions to qualified basis under IRC S42(f)(3)(B). Otherwise, there is no authority for disallowing credits on a monthly basis.

Filing Requirement: State Agency's Annual Report under IRC §42(l)(3)

Each state housing agency that allocates IRC §42 housing credit to any building for any calendar year submits an annual report to the IRS. The report must specify the amount of credit allocated to each building for each year, and include sufficient information to identify each such building and the taxpayer owning the building. Under the Code, state agencies must also submit other information as the IRS requires. This requirement is satisfied when a state agency files Form 8610, Annual Low-Income Housing Credit Agencies Report, with supporting attachments:

- Forms 8609, Low-Income Housing Credit Allocation and Certification, with Part I completed, signed and dated;
- Schedule A (Form 8610), Carryover Allocation of Low-income Housing Credit; and
- If applicable, information about buildings receiving disaster relief under Rev. Proc 2007-54 or Rev. Proc 95-28.

The information on these forms provide the means for each agency and the IRS to reconcile the allocation of credit for each building with the aggregate amount of credit available for allocation under the state's housing credit ceiling. A housing agency must not allocate more credit than it is authorized to allocate during the calendar year.

Form 8610 also requires a state agency to certify under penalties of perjury that, for the reporting year,

- the state's qualified allocation plan was in effect,
- the state agency was in compliance with the compliance monitoring requirements, and
- the state agency fulfilled its noncompliance notification responsibilities.

The due date for filing of the annual certification (Form 8610 and attachments) is February 28th after the close of the calendar year in which IRC §42 credit was allocation to a qualified low-income

building. In states with multiple agencies allocating credit (including states with constitutional home rule cities), the agencies must coordinate and file a single completed Form 8610.

The penalty under IRC §6652(j) is applicable if a state agency fails to timely submit its annual report unless it is shown that the failure was due to reasonable cause and not willful neglect. The amount of the penalty is $100. The penalty may be applied regardless of the fact that an annual report was submitted if it is inaccurate or incomplete; e.g., missing required forms that make up the report.

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, contains four blocks of information to account for adjustments that reduce a credit carryforward. Blocks 46 through 47 identify the type of credit and the extent of any adjustment made. See IRM 4.4.12.4(58) and (59) for instructions.

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 LIHC property owners are almost always partnerships, and are likely to be subject to TEFRA procedural requirements, please remember 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

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♫Grace Notes♫

I reported last time that March made its entrance like a roaring lion, but I am perplexed as to how I should report its exit. March 31st was a balmy spring day; the sun was shining, the skies crispy blue, and daffodils blooming everywhere. Even the air smelled fresh and clean. But early the next morning, I found myself driving in drizzly rain and fog so thick the traffic around the beltway actually slowed to a mere 45 mph. So, my dilemma is this: did March exit like a lamb at 11:59 and a smidge past 59 seconds pm on March 31st, or did April boot March into history just a smidge after 00:00 am on April 1st?

April lived up to its reputation for showers, but the tulips and daffodils sprouted, bloomed and wilted well before the expected arrival date for May's flowers. It is still raining as I finish this newsletter on May 1st, and the weatherman is predicting a steady drizzle for the next week. I suppose May will officially start if and when any new flowers show up…I'm betting on the irises!

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