

*This article was originally published in **The Compliance Monitor**, Volume 9, Issue 5. **The Compliance Monitor** is published by Elizabeth Moreland Consulting, Inc. In this article, Elizabeth Moreland, national Housing Credit Program expert, discusses Revenue Ruling 2004-82 and its affects on your compliance operations.*

## **IRS Clarifies 12 Important Issues on Compliance**

*By Elizabeth L. Moreland, NCP-E, SCS*

On July 29, the Internal Revenue Service issued Revenue Ruling 2004-82 which answered 12 industry questions regarding Tax Credit compliance based on existing Code and the legislative history.

This particular revenue ruling was written in a question and answer format and is comprised of seven different sections or issues which include (A) Eligible Basis & Qualified Basis; (B) First Year Low Income; (C) Extended Low Income Housing Commitment; (D) HOME Investment Partnership Act Loan; (E) Vacant Unit Rule; (F) Recordkeeping and Record Retention; and (G) Tenant Income Documentation.

I have thoroughly reviewed the IRS's responses and have summarized them for you in this article.

### **Eligible & Qualified Basis Issues**

The first two questions address the use of units for security officers and police substations and whether or not these units can be included in eligible basis.

#### Question 1

The first question is broken into two parts and relates to whether a unit occupied by a full-time

security officer can be included in the building's eligible basis and applicable fraction.

The IRS's response was not surprising as it stated that YES the unit could indeed be part of the eligible basis as this type of unit is reasonable required by the project, but NO it was not part of the building's applicable fraction – numerator (top) or denominator (bottom) – as the unit was not a residential rental unit.

They went on to clarify that if in the future the unit is converted to a residential rental unit, it would be includable in the denominator or bottom of the fraction and included in the numerator or top of the fraction only if occupied by a qualified household.

For those of you who are attendees or graduates of the Housing Credit College, there is nothing surprising here.

#### Question 2

The second question is also a two-parter and addresses police substations, specifically whether such facilities can be included in the building's eligible basis and applicable fraction.

The IRS responded similarly to Question 1 and stated YES to being includable in eligible basis and NO

to being includable in the top and bottom of the applicable fraction.

Their reasoning is based on the community service facility code provision contained in Section 42(d)(4)(C)(iii) which states the facility is designed to serve primarily individuals whose income is 60% or less of area gross median income (AMGI) as it will help the quality of life for the resident; there was a market study done to prove this facility would be appropriate and helpful to not only the residents of the property but the area surrounding the property, the facility was located within the building; and the services provided by the facility are affordable to individuals at or below 60% AMGI.

However, as the facility is not a residential rental unit, it cannot be placed in the building's applicable fraction – numerator or denominator.

Personally, I think this is a welcomed interpretation of the code as I have heard numerous opinions over the years.

#### Question 3

And the third question in this section addressed whether credit application and allocation fees

could be included in the building's eligible basis.

The IRS response was NO as these fees are not capitalizable into the adjusted basis of the building, however depending on the specific facts and circumstances, all or part of the fees may be required to be capitalized as amounts paid to create an intangible asset or if they don't meet these requirements as stated in Section 1.263(a)-4 of the Internal Revenue Code, they may be deductible as an ordinary and necessary expense provided the owner meets the requirements contained in Section 162 or 212 of the Internal Revenue Code.

Again, this answer should not be surprising to those of you who are Housing Credit College alumni.

### **First Year Low Income Unit Issues**

The next section contains Question 4 and addresses the first year occupancy issues and the prorated applicable fraction.

#### Question 4

The specific question resolved a point of contention for many as the IRS stated that as long as a building was placed in service for a FULL month, the occupancy date of a resident during that month does not affect the ability to include that unit in the building's month-end applicable fraction.

In other words, if you have a building that was placed in service on October 1, 2004 and a qualified household occupied a unit on October 29, 2004, the unit would be included in the building's fraction (numerator and

denominator) for the month of October.

### **Extended Low Income Housing Commitment Issues**

This section contains Question 5 and deals with an issue that many are not familiar with, however, need to be. The issue I am speaking about is the prohibition of evicting or terminating the tenancy of Tax Credit residents during the extended use period.

Those of you who have been to a recent Housing Credit College course know that we have seen some recent court precedent on this issue but now we are seeing the IRS weigh in. Let's examine the question specifically.

#### Question 5

The question addressed whether the extended use agreement (or land use restriction agreement as many states call it) must prohibit evictions or tenancy terminations without good cause or rent increases beyond the allowable Tax Credit maximum only during the 3 year period after the end of the extended agreement.

I think we need to examine this question a bit first before we dive into the answer to be sure you understand its importance.

The extended use period is the period beginning the first day in the compliance period and ends on the date specified by the state in the regulatory agreement or 15 years after the close of the compliance period, whichever is later. Many of you have 15 year extended use periods, but an equal number of

you have extended use periods of 20, 30, and even more years.

The Code – Section 42(h)(6)(E)(ii) – states that it will not be permitted to evict or terminate the tenancy of an existing resident without good cause or increase the Tax Credit rent beyond the maximum allowable rent before the end of the 3 year period following the end of the regulatory agreement.

This was construed to mean that such tenancy terminations (those without good cause) and rent increases (those over the maximum allowable) would not be allowable for 3 years after the end of the extended use agreement. In English, that means that if your extended use agreement would end in 2010, you would have to follow these provisions for an additional 3 years or until the end of 2013. As you can see, this is basically a protection for existing Tax Credit households who are living in a building that is no longer part of the Program by giving them an additional 3 years before their unit can be converted to market rent.

However, when the IRS researched the Code and legislative history for answering this question, they noted that Congress added to this language as part of the Omnibus Reconciliation Act of 1990 emphasizing its importance. And because the Code provision already existed, the IRS construed this to mean that when Congress emphasized it in the OBRA 1990, they must have meant it should be applied throughout the extended

use period, not just the 3 years after the period ended.

Therefore, the answer to the question was NO, the prohibitions on eviction and rent increases was not just for the 3 year period after the extended use agreement ended but also during this period.

Further, it states that if an owner's regulatory agreement does not contain this provision, it is not a valid agreement and the credits are not allowable for that taxable year or prior taxable years. However, if the agreement is corrected within 1 year from the date of the discovery, the loss of credits will not apply. State housing agencies have until December 31, 2004 to review their extended use agreements and if any invalid agreements are discovered, the 1 year correction period will start on the date of discovery.

Not a fun one. Here are my recommendations. Contact your State Agency and determine their plans for reviewing these documents and whether they have concerns regarding the validity of their agreements. You may also want to review your own regulatory agreements to determine if this clause is included. Be sure the language is not just for the 3 year period following the end of the agreement rather for the entire extended use period. If you feel your agreement is invalid, be sure to contact your State Agency and request it be corrected.

### **HOME Investment Partnership Act Loan Issues**

This section contains 2 questions both of which contain multiple parts all of which are important for

those of you who have HOME/Tax Credit deals.

#### **Question 6**

Question 6 addressed how HOME/Tax Credit deals that are 9% deals (70% present value credits) must apply the special set-aside requirement regarding increasing the number of 50% AMGI units and what are the rents on these units.

The IRS responded by saying the special set-aside requirement requires the owner to have 40% of the units **in each building** at or below 50% and that the rents on these units are limited to the minimum set-aside requirement not the special set aside requirement. Therefore, if you have 2 buildings of 100 units each, are 100% Tax Credit with a 40/60 minimum set-aside, and make the special HOME set-aside election, you must have 40% or 40 units in each building at or below 50% AMGI, however those units rents will be based on the 60% AMGI.

#### **Question 7**

Question 7 addresses when a Tax Credit deal would be eligible for the 130% bump in eligible basis.

For those of you unfamiliar with the 130% increase or "bump" in eligible basis, this is available to owners who build Tax Credit properties in Qualified Census Tracts (QCT) or Difficult to Develop Areas (DDA) as indicated by HUD. Such properties are allowed to increase their eligible basis by 130% for building in these areas; however properties using

HOME funds are not always eligible for this bump.

The IRS stated that the 130% bump is available if the HOME funds are included in eligible basis because the building would then be considered federally subsidized or a 4% (30% present value) deal which makes it eligible. They also stated that if the owner borrowed the HOME money at the applicable federal rate, the building would be a 9% deal (assuming it met all the other criteria to be a 9% deal) and therefore it would not have to make the special HOME set-aside. Because the owner would not have to elect the special HOME set-aside, the eligible basis would be eligible for the 130% bump. And finally, they stated that if the borrower received the HOME funds below the applicable federal rate, it would be eligible because it would be a federally subsidized or 4% deal.

### **Vacant Unit Rule Issues**

This section contains 3 questions in regards to the Unit Vacancy Rule issue specifically how should different building unit transfers be handled, what constitutes a unit being "available" or "vacant", and what is the definition of reasonable attempts.

#### **Question 8**

This question describes a unit transfer of a qualified household between different buildings in the same project. Specifically the scenario describes a household who is qualified and initially labels a unit and later requests to transfer to a unit in a different building that was not previously labeled as Tax

Credit. The question inquires whether both units would be considered Tax Credit after the transfer took place.

The IRS's response was NO as they feel that the same resident, even if qualified at both move in and at the time of the transfer, cannot qualify two different units at the same time. To quote the ruling, "...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." In such occurrences, the original unit's status would be "turned off" and the new unit's status would be turned on.

Personally, this is quite troubling to me, but it seems to be a strong stance the IRS has taken as I've seen numerous responses to this question from the IRS and the answer has consistently remained the same.

### Question 9

Question 9 addresses what constitutes reasonable attempts to rent a vacant Tax Credit unit.

The IRS's response was that reasonable attempts would be based on the facts and circumstance, and may differ from project to project depending on size, location, occupancy, market conditions, and available advertising methods.

In the scenario that surrounds the question, the owner took normal steps to market the vacant Tax Credit unit including hanging a banner, placing classified ads in two local newspapers, putting up

for rent signs at the entrances of the property, contacting prospective tenants on the waiting list and contacting the local public housing authority. The IRS responded that all of these items constituted reasonable attempts in this scenario and it would not be noncompliance to rent a comparable or smaller market rate unit first.

### Question 10

In this question, the IRS was asked what constitutes a unit being available for the purposes of this rule.

The IRS responded by saying a "*unit is not available for purposes of this rule when the unit is no longer available for rent due to contractual arrangements that are binding under local law, such as a reservation entered into between a building owner and a prospective tenant.*"

Once again, those of you who attend Housing Credit College courses, this should come to you as no surprise.

### **Recordkeeping and Record Retention Issues**

This section contains a single question regarding record retention.

### Question 11

Question 11 asks whether an owner can retain just an electronically-stored version of its records without retaining the hard copies.

The IRS's response was YES as long as the electronic storage system requirements meet Revenue Procedure 97-22, but that the owner must also satisfy his state agency's

requirements on this matter which may include the retaining of the paper copies.

### **Tenant Income Documentation Issue**

The last section contains a single question regarding tenant income and the appropriate type of verifications.

### Question 12

The question specifically addresses whether a sworn self-certification would suffice as proper documentation for a tenant who states he or she is not receiving child support payments.

The IRS's response was YES as long as the sworn self-certification had a statement stating the person was not receiving child support and would indicate whether the tenant would be seeking or expecting such support in the next 12 months.

Good news for those of us in the trenches struggling with this issue. However, I do need to point out that the IRS did state the owner must satisfy its state agencies procedures as well.

So there you have it. Twelve answers to twelve troublesome compliance questions. Some answers were as we expected and others will cause us to tweak operations.

A copy of Revenue Ruling 2004-82 for your own library can be obtained by going to [www.nationalcompliancepro.com](http://www.nationalcompliancepro.com). I highly recommend that you obtain a copy for your own archives and thoroughly read it so you familiarize yourself with this

important document and can make your own assessment of its contents.

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Elizabeth Moreland is the President of Elizabeth Moreland Consulting, Inc. and the Housing Credit College where she has been helping industry professionals to become *Compliance Confident* for over 10 years! Check out her full array of Housing Credit workshops and compliance services by visiting [www.housingcreditcollege.com](http://www.housingcreditcollege.com)!