

# Low Income Housing Credit Newsletter

Internal Revenue Service

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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.**

*Editor's Note:* In the sixth issue of the newsletter, issued way back in June of 2002, I wrote an article about a technical issue that was then surfacing as part of our audit activities. It has come to my attention that taxpayers may be inappropriately relying on the contents of that newsletter – particularly since the article is now six years old and there have been changes to the filing requirements – so, in this issue, we will again discuss how issues involving the IRC §42(l)(1) certification should be developed during an IRS audit. I'd also like to bring your attention to the disclaimer above, which has been part of the header information above beginning with the 22<sup>nd</sup> newsletter issued in September of 2006.

## **IRC §42(l)(1): Owner's Certification with Respect to the First Year of the Credit Period**

Under IRC 42(l)(1), a taxpayer must certify with respect to the first year of the credit period:

1. the taxable year and calendar year in which qualified low income buildings were placed in service,
2. the adjusted basis and eligible basis of such buildings as of the close of the first year of the credit period,
3. the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under IRC §42(h),
4. the election made under IRC §42(g) with respect to the qualified low income housing project of which such building is a part, and
5. other information as the Secretary may require.

The certification is made to the Secretary of the Treasury and must be made following the close of the first taxable year in the credit period for any qualified low income housing building. Unless it is shown that failure to certify the first

year of the credit period is due to reasonable cause and not to willful neglect, no credit will be allowed with respect to such building for *any* year before such certification is made.

### Making the IRC 42(l)(1) Certification

Part I of Form 8609, Low-Income Housing Credit Allocation and Certification, completed and signed by the state agency, documents approval of the finished low-income housing building and identifies the amount of the allowable annual low-income housing credit. Taxpayers must complete and sign Part II of the Form 8609 issued by the state agency and then file the form with the Philadelphia Campus to complete the IRC §42(l)(1) certification.

Reg. §1.42-1(h) addresses the filing of forms, stating that the requirements for completing and filing Form 8609 are addressed in the instructions to the form. The instructions read:

**Building owner.** You must make a one-time submission of Form 8609 to the Low-Income Housing Credit (LIHC) Unit at the IRS Philadelphia campus. After making a copy of the completed original Form 8609, file the original of the form with the unit no later than the due date (including extensions) of your first tax return with which you are filing Form 8609-A, Annual Statement for Low-Income Housing Credit

Form 8609-A, Annual Statement for Low-Income Housing Credit, which is filed with the taxpayer's federal tax return for each year of the 15-year compliance period, is used to compute the allowable credit for that year. In Part I of the form, Question C asks whether the taxpayer has the original Form 8609 (or copy) signed and issued by the state agency. The instructions for this line read:

Item C. In order to claim the credit, you must have an original, signed Form 8609 (or copy thereof) issued by a housing credit agency assigning a BIN for the building. This applies even if no allocation is required (as in the case of a building financed with tax-exempt bonds). Check “Yes” to certify that you have the required Form 8609 in your records.

Caution: Any building owner claiming a credit without receiving a completed Form 8609 that is signed and dated by an authorized official of the housing credit agency is subject to having the credit disallowed.

To summarize, three important changes have been made since 2002:

1. The certification requirements apply to both low-income credits allocated under IRC §42 and buildings financed with tax-exempt bonds under IRC §142(d) and receiving credits associated with the volume cap under IRC §146.
2. The certification must be made no later than the due date (including extensions) of the first tax return with which the taxpayer files Form 8609-A, Annual Statement for Low-Income Housing Credit and claims credit.
3. Taxpayers make the certification *one time* by filing the Form 8609, Low-Income Housing Credit Allocation and Certification, with the IRS Philadelphia Campus.

#### Audit Activity

The IRS has identified tax returns where the taxpayer is claiming the low-income housing credit, but does not have Part I of the Form 8609, Low-Income Housing Credit Allocation Certification, from the allocating state agency. Taxpayers without the Forms 8609 may be claiming the credit amount identified in carryover allocation documents executed by a state agency under IRC §42(h)(1)(E) or (F). The credit computation is shown in Part II of Form 8609-A, Annual Statement for Low-Income Housing Credit. In Part I, for Question C, which asks whether the taxpayer has the Form 8609 signed and issued by the state agency, taxpayers

are either answering “no” or are leaving the question unanswered.

In addition, taxpayers are filing Forms 8609 with only Part II completed to the Philadelphia Campus to complete the first year certification. The submission may include an explanation that the taxpayer has provided the state agency with all the information necessary for the state agency to make a final determination of the credit amount under IRC §42(m)(2)(C)(i)(III) and that the certification is being made in advance of the state agency’s final approval of the taxpayer’s building as a qualified low-income building.

#### Examination Requirements: Taxpayer Obtains Forms 8609 from State Agency

There is no prohibition against satisfying the certification requirements during the examination process (see Chief Counsel Advisory 200137044). The taxpayer should be given the opportunity to provide completed Forms 8609 (signed by the state agency) and Part II completed and signed by the taxpayer. If the taxpayer presents Forms 8609 signed by the state agency, then the following four issues must be addressed:

1. Determine whether the credit claimed by the taxpayers in years before the certification is more than the annual credit actually allocated by the state agency. The examination should be expanded to include prior years to disallow credit in excess of the credit amount allocated by the state agency. The recapture provisions under IRC §42(j) should be applied to prior year returns closed by statute.
2. Verify that the taxpayer’s elections and past filings are consistent. For example, the taxpayer may have elected to begin the credit period the first year after the building was placed in service, but actually claimed credits for the year the building was placed in service. If this happens, the taxpayer has created documentation to support claiming the credit for eleven years rather than for the prescribed ten-year credit period under IRC §42(f)(1). The SBSE Headquarters analyst should be contacted if this issue is identified.
3. Verify the costs included in Eligible Basis, the computation of the Applicable Fraction

under IRC §42(f)(2), and the Minimum Set-Aside for the first year of the credit period to confirm that the credit has been correctly computed. Including costs incurred after the end of the first year of the credit period in Eligible Basis is of particular concern.

4. Determine whether the failure to timely complete the IRC §42(l) certification was due to reasonable cause or willful neglect. The taxpayer can claim the credit for tax years before the state agency provided the Form 8609 only if the taxpayer can demonstrate (1) a reasonable cause for not timely completing the IRC §42(l)(1) certification, *and* (2) that the failure to complete the IRC §42(l)(1) certification was not due to willful negligence.

#### *Reasonable Cause*

“Reasonable cause” means that the taxpayer exercised ordinary business care and prudence in determining its tax obligations but is unable to comply with those obligations. To establish reasonable cause, taxpayer must explain why they claimed the credit before completing the IRC 42(l)(1) certification. (See IRM 20.1.1.3.1)

Taxpayers commonly argue that the circumstances were beyond their control. The Forms 8609 were timely requested from the state agency after the end of the year in which the property is placed in service, but were not received before filing its tax return. Factors to consider:

1. When was the request for the Forms 8609 made? What follow-up efforts did the taxpayer make to secure the Forms 8609?
2. Why did the state agency fail to provide the Forms 8609 (Part I completed and signed)? State agencies generally attempt to provide the completed forms quickly. Failure to do so is indicative of problematic properties; i.e., the cost certifications may not be complete, the state may have determined that the property was built using sub-standard materials, or the property was not built according to the contract, etc. The state agency should be contacted to determine the cause of the delay. Most state agencies keep records of their contacts with property owners; determine if and why the

taxpayer delayed in responded to the state agency’s inquiries.

A determination of reasonable cause must be based on an evaluation of all the facts and circumstances on a case-by-case basis. Consider the following factors:

1. How long after the end of the first year of the credit period did the taxpayer receive the Forms 8609? How many years has the taxpayer claimed the credit without having the Forms 8609? How did the taxpayer answer question C on Form 8609-A?
2. Did the taxpayer encounter other difficulties while noncompliant with the IRC §42(l)(1) certification requirement, and how were the problems resolved?
3. What reason did the taxpayer give for the delay? To show reasonable cause, the dates and explanations should clearly reflect efforts to timely resolve noncompliance with IRC §42 and expeditiously obtained the Forms 8609 from the state agency.
4. Did the taxpayer know, or make reasonable attempts, to determine the IRC §42(l)(1) certification requirements? Is the general partner a professional specializing in the development and management of IRC §42 properties?
5. Did the taxpayer make a mistake? How long was it before the taxpayer corrected the mistake? Generally, errors do not provide a basis for reasonable cause, but additional facts and circumstances may support such a determination. Forgetfulness, oversight, or reliance upon another person does not support a determination of reasonable cause for failing to timely making a required filing.
6. Death, serious illness or unavoidable absence of the taxpayer may establish reasonable cause. Consider the relationship of the responsible party to the taxpayer; the dates, duration of the illness or absence; how the event prevented compliance; whether other business obligations were impaired; and whether the noncompliance was remedied within a reasonable period after a death or absence.

### *Willful Negligence*

As used by the Supreme Court in *United States v. Boyle, Executor of the Estate of Boyle*, 469 U.S. 241, the term "willful neglect" may be read as meaning a conscious, intentional failure or reckless indifference. Under Treas. Reg. 1.6662-3(b):

1. Negligence includes any failure to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care in the preparation of a tax return.
2. A disregard of rules or regulations is "reckless" if the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances that demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe.
3. A disregard of rules or regulations is intentional if the taxpayer knows of the rule or regulation that is disregarded. Taxpayers often include a statement with their return to the effect that the Forms 8609 have been requested but have not been received from the state agency.

See IRM 20.1.5.7 for additional discussion.

### Examination Requirements: Taxpayer Does Not Obtain Forms 8609 from State Agency

If the taxpayer cannot complete the IRC §42(l)(1) certification during the audit, then:

1. The entire credit should be disallowed in all years open by statute. Under IRC §42(j), a portion of credit can be recaptured in years closed by statute or otherwise not examined.
2. Determine whether the on-going delay in completing the IRC 42(l)(1) certification is due to reasonable cause. If reasonable cause is established, the taxpayer should be cautioned that statutes should be extended (or protective claims for refunds filed) to ensure that the taxpayer can amend returns to claim the credits at a later date when the amount of allowable credit is determinable.
3. The examination should include verification of the Eligible Basis, the Applicable

Fraction, and Minimum Set-Aside for the first year of the credit period, as the taxpayer may be able to claim the prior year credits at a later time or claim credits beginning with the taxable year in which the Forms 8609 are received from the state agency.

4. If the failure to complete the certification process is not due to a reasonable cause or is due to willful neglect, the entire credit should be disallowed in all years open by statute. Under IRC §42(j), a portion of credit can be recaptured in years closed by statute or otherwise not examined. No credit is allowable for any tax year before the IRC §42(l)(1) certification is completed.

### Penalties

Penalties should be considered if the LIHC is disallowed and/or recaptured; i.e., the taxpayer has not completed the IRC §42(l)(1) certification and was either (a) found to be willfully negligent, or (2) was not able to establish a reasonable cause for the failure. Responsible parties, such as a general partner or TMP, should be identified and consideration given to the aiding and abetting penalty under IRC §6701. This penalty applies to persons who are directly involved in aiding or assisting in the preparation of a false or fraudulent document under the tax laws. See IRM 20.1.6.6 for full discussion and procedures.

### Conclusion

The importance of the IRC §42(l)(1) certification cannot be overemphasized; it isn't simply "paperwork." First, there's always the possibility that a taxpayer is fraudulently claiming the credit; i.e., the taxpayer does not have an allocation or even a carry-over allocation of credit from a state housing agency. Further, even if the taxpayer has entered into a contract with the state agency, the IRS has no way of knowing that the state agency has approved the completed project, the amount of credit the taxpayer is entitled to claim, or the terms of the allocation until the taxpayer completes the IRC §42(l)(1) certification. If audited by the IRS, the credit will be disallowed and the recapture provisions will be applied simply because the amount of allowable credit is unknown.

Second, claiming the credit without completing the certification creates a very specific duty of consistency (see Bentley Court II, *T.C. Memo*

2006-11). For example, the amount of credit claimed by the taxpayer before receiving the Form 8609 from the state agency must be consistent with the amount of credit subsequently allocated by the state agency and the elections made on Form 8609 must be consistent with the taxpayer's behavior before completing the certification. Under IRC §6001, the taxpayer must provide adequate proof of consistent behavior, which can include providing prior year federal tax returns.

Finally, the taxpayer bears the burden of demonstrating that there was a reasonable cause for failing to complete the IRC §42(l)(1) certification before the due date (including extensions) of the first tax return on which the credit was claimed. Failure to provide a reasonable cause will result in the disallowance and/or recapture of IRC §42 credits.

### **Guide for Completing Form 8823: Updates Pending**

In January of 2007, the IRS released a new Guide for Completing Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition. The IRS is now drafting revisions to update the guide. Revisions will be made to include HUD's changes to Handbook 4350.3 (used to determine whether households are income-qualified), a new exception for student households, and changes to Regulation 1.42-10, Utility Allowances, which we anticipate will be finalized in the very near future. There will be clarification and more examples...and we'll deal with those pesky typos!

### **New LIHC Audit Technique Guide: Request for HELP!**

The IRS is now drafting a new audit technique guide (ATG) for IRC §42. The existing ATG, written in 1999, is very outdated and is no longer available for use. ATGs are written for examiners, but are also made available to the public to help taxpayer comply with the requirements of the Internal Revenue Code. We hope to have the first draft ready for Chief Counsel review by December 31, 2008. When ready, a draft will be released for public comment

To help get the project started, I would like to invite anyone (within the IRS or beyond) with ideas for content, format, etc., to send me an e-mail at [Grace.F.Robertson@irs.gov](mailto:Grace.F.Robertson@irs.gov) before September 1, 2008.

### **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 44 through 47 identify the type of credit and the extent of any adjustment made. See IRM 104.3.12.4.55 through 58 for details.

**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.

[http://tefra.web.irs.gov/m1/1a\\_home.asp](http://tefra.web.irs.gov/m1/1a_home.asp)

## Subscribing to the LIHC Newsletter

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### ♪ Grace Notes ♪

*I recently met with the state housing agencies with which the IRS shares administration of the program; I'm always impressed and uplifted by their enthusiasm for the program. I shared some information about our audit activities with them, and thought others would be interested as well.*

*There are a sufficient number of LIHC examinations in process; 64% of the audits were initiated based on information provided by the state agencies on Form 8823. By the way, since the release of the Guide in January of 2007, there's been a marked change in the both the quantity of forms submitted and the quality of the filings. There are fewer filings but the states are providing more accurate and complete filings. However, the state agencies' reports are not the only source of audit work; e.g., LIHC issues have been identified through the partnership classification process and on returns selected for training purposes. And we don't audit just the partnership owning the LIHC property; we are also auditing developers, nonprofit entities, and investors.*

*31% of our audits right now were originally identified because the owner had not completed the IRC §42(l)(1) certification - which is one reason why I decided to provide an updated article on the issue. 20% are selected for technical issues and another 19% because the owner didn't correctly report the disposition of the LIHC property. 15% of our audits involve properties that are not physically maintained and are not suitable for occupancy. Another 8% are audits of owners who still own the property but who are no longer participating in the program. Finally, about 7% of our audits involve tenant and rent related issues, remember, the*

*households are eligible to live in LIHC housing based on their income and the rents must be restricted - simple to say, more difficult to accomplish (and document).*

*So, that's how our examinations begin. The middles and ends of our audits are much harder to predict or quantify because the issues surfaced during the examination can be very different from what we anticipated.*

*What I do know, however, is that we've just past the middle point of the summer...and it is predictably and quantifiably hot and humid here in Northern Virginia. It's early on a Monday morning and I'm writing this at the kitchen table. To the left, I can look out a bay window onto the pleasant, tree-lined suburban street where I live...just a few early commuters have passed by. Normally, I would see kids on the corner and hear their chattering while they wait for the school bus, but they're sleeping in. I remember way back when I did that, too.*

*To my right, I can look through the sliding doors onto the deck where a rather plump chipmunk is sitting in a ray of early morning sunlight and washing his face. I'm thinking that his motions are not much different than those my cats would make, which isn't much of an intuitive leap since both cats are laying by the door drooling. The chipmunk is a frequent visitor and seems very comfortable, so I'm pretty sure he knows he's driving them crazy.*

*It is a peaceable moment before what I know will be a long and hectic day. I hope you have such a quiet moment once in a while, too.*

Grace Robertson  
Phone: 202-283-2516  
[Grace.F.Robertson@irs.gov](mailto:Grace.F.Robertson@irs.gov)