28th Annual Forum on Affordable Housing
And
Community Development
Tax Credit Hot Topics
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Discussion Topics and Relevant Authority

Recently Issued Guidance

Final Compliance Regulations (Income Tax Regulation 1.42-5): On February 26, 2019, Treasury and the IRS issued final regulations on how state housing finance agencies must monitor low-income housing tax credit properties to ensure that they are compliant with the requirements of Internal Revenue Code Section 42. Some of the changes include requirements that a minimum number of units to be inspected (based on the number of low-income units in the project) that each building in the project be inspected and that lowers the reasonable notice of inspection is lowered from 30 days to 15 days. The Regulation generally provides that the same unit not be subject to both a file review and physical inspection, unless selected randomly, in which case the unit inspection would need to be completed on the same day. Some of the changes could result in more work on the part of asset managers and housing credit agencies, and could also result in increased compliance monitoring fees.

Revenue Procedure 2019-17 clarified that the general public use requirements for qualified residential rental projects financed with tax-exempt bonds are the same as the requirements for projects that are developed using an allocation of tax credits. Previously, a project using allocated tax credits could have a preference for groups such as veterans, but those financed by tax exempt bonds could not. The Revenue Procedure makes it clear that the allowable preferences are the same under both scenarios.

Final Utility Regulations (Income Tax Regulation 1.42-10): On February 27, 2019, Treasury and The IRS issued final Regulations concerning the utility allowances required under Code Section 42. The Regulations set out rules that apply when the owner purchases a utility from a utility company and separately charges the tenants for the utility. The Regulations state that if the charge to the tenant is based on actual consumption, it will be treated as though the payment was made directly to the utility company, even though the payment was actually paid to the owner. The Regulations also provide guidance on situations where the owner sells energy to the tenants that it produced from a renewable energy source, requiring that the amount charged to the tenant not exceed the highest rate that the tenant might have paid to a local utility company.
Other Topics

Income Averaging:

In 2018, Congress revised Code Section 42 to include a new option for the minimum set-aside that a project must meet to qualify as a low-income housing tax credit project. To qualify, at least 40% of the units must be rent restricted and occupied by families whose income does not exceed the imputed income limitation designated by the owner with respect to the unit. The designation percentage can be 20%, 30%, 40%, 50%, 60%, 70%, or 80% of Area Median Income (“AMI”), but the average of the designated income limits must not exceed 60% of AMI. Numerous questions have arisen relating to the election and compliance with the new set-aside. While this topic is on the second quarter priority guidance list, no official guidance has yet been provided.

State Tax Credit Transactions:

Although there have not been any new cases on the use of state credits, there does seem to be a market for these credits. With the lower federal tax rate, the state credits are even more valuable to the buyer. Recently, more states have been enacting state tax credit programs. How are practitioners structuring deals that use the proceeds of state tax credits? Are the credits deemed to be allocated or a sale of property?

Historic Tax Credits:

Historic – Over the past several years, there have been two significant changes to historic tax credit transactions.

First, Rev. Proc. 2014-12 established a safe harbor with abundant limitations about what features the developer of a project can guarantee to the investor. Most notably, the managing member cannot guarantee against “structure risk,” generally interpreted to prevent a guarantee that the investor will be respected as a partner. In analyzing safe harbor questions for Section 42 projects, many firms perceive a difference between (A) “single tier” investments, where the same investor is allocated the LIHTC and the HTC, where it generally seems unnecessary to apply the safe harbor tests, and (B) “two tier” investments, where the landlord tier owns the property and allocates the LIHTC to its partners, while the master tenant tier actually operates the housing and the HTC is “passed through” and allocated to its partners, who are different from the ones investing in the Landlord, where it seems far more appropriate to apply the safe harbor tests to the HTC investors. In any case, two of the more popular questions are first, whether structure and other guarantees are appropriate in twinned structures, and second, what should the master tenant do with the investor’s money – hold and use it to buy personal property? Make a capital contribution to the landlord? Make a rent prepayment to the landlord which then has Section 467 implications? Or perhaps just a simple loan?
Second, the Bipartisan Budget Act turned the one year, 20 percent HTC into a five year, 4% per year credit for many transactions. This raises a large number of questions, and one in particular when the HTC interacts with the LIHTC: Is all of the 20% basis reduction associated with the HTC taken in the first year of the LIHTC credit period, thereby reducing the LIHTC eligible basis by the full amount? Or is just the first 4% taken, with the remaining reduction associated with the next four years’ credits escaping this treatment?

**130% Basis Boost Safe Harbor:**

If at the time a project applies for tax credits or bond financing, the project is located in a QCT or DDA, but is not listed at the time the credits are allocated or when the bonds are issued, the project may still may qualify for the 130% basis boost. In order for this to apply, the allocation of credit has to be made no later than the end of the 730-day period after the submission to the Credit Allocation agency a complete application and the submission is made before the effective date of the subsequent list (that did not include the tracts in which the project is located). For bond financed projects, the project will qualify for the 130% basis boost if the bonds are issued or the building is placed in service no later than the end of the 730-day period after the applicant submits a complete application to the bond issuing agency. Recently, questions have arisen as to what is deemed to be a complete application. Per the HUD notice designating QCTs and DDAs, a “complete” application means that “no more than de minimis clarification of the application is required for the agency to make a decision about the allocation of tax credits or the issuance of bonds requested”. To what degree can an application change and still be de minimis?

**4%/9% Combined Projects:**

Recently, there have been more projects that blend the 4% and 9% credits. In fact, several states are giving extra points to a project that combines the two credits. In TAM 95-28002, the IRS held that even though only part of a project was financed using tax exempt bonds, all buildings in the project were tainted due to cross collateralization and because the bond indenture did not limit which buildings the bonds on which the bonds could be spent. In PLR 200035016, the IRS found that tax exempt bonds could not be used to fund the acquisition of a project and allocated credits apply solely to the rehab since it was one single plan of financing and the rehab was tied to the acquisition. Until recently, to be two projects, there had to be separate buildings in different legal entities with different owners and no common plan of financing. More recently, we have seen the projects use condominium structures to allow the 4% and 9% projects to be in one building with the same legal ownership. Questions do arise on how to treat common area costs to avoid tainting the 9% project.
Use of Condominium Structure:

We frequently see buildings broken into multiple condominiums. This structure is being used for various purposes. It might be a way to combine 4% and 9% tax credits in a single building or it could be a way to break out the market rate units from the tax credit units, which might be a way to lessen or eliminate the recertification requirements for a project or to mitigate compliance risks for a project using income averaging. Notice 88-91 supports a condominium being treated as a separate building, stating “Final regulations will provide that the term “qualified low-income building” includes residential rental property that is either an apartment building, a single-family dwelling, a townhouse, a row-house, a duplex, or a condominium.” But PLR 201103006 treated multiple condominiums in a single physical building as one building because it was constructed under a single contract, operated as a single building and had a common plan of financing.

Department of Justice investigation on Price Fixing on Tax Credit Projects:

Recently, the Department of Justice initiated an investigation into whether investors have been “colluding with developers” to drive down the price of the tax credits. Among other things, the allegations include investors agreeing to pay a developer a below market price in exchange for a commitment to invest or fund a less desirable project. In addition, the allegations include the practice of a lender providing financing for a project in exchange for the commitment to sell them the tax credits rather than allow the credits to be sold on the market.

Special allocation of expenses to General Partner:

With the reduced pricing that resulted from tax reform, more transactions are running into reallocation issues and/or significantly large negative capital accounts. The reallocation issues can result in a reallocation of tax credits and the significant negative capital account can result in a larger payment of exit taxes required to exercise the right of first refusal. Allocations of deductions will be respected if they are either in accordance with the partners’ interest in the partnership or if they have substantial economic effect. Substantial economic effect is a safe harbor and requires that the allocation (1) have economic effect and (2) that the economic effect be substantial. An allocation will be substantial if there is a reasonable possibility that the allocation will affect substantially the dollar amounts to be received by the partners from the partnership, independent of the tax consequences. An allocation will lack substantiality if the allocation has favorable tax consequences to one partner without corresponding detrimental tax consequences to the other partners and no overall change in the partners’ capital accounts. With this framework, we are seeing various versions of special allocations. Some are specially allocating amounts that are paid or payable to the General Partner, others are specially allocating all expenses that are not part of minimum gain. Can more than 49% of an expense item be allocating to a related seller if the partnership claims an acquisition credit?
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Materials

Amendments to the Low-Income Housing Credit Compliance Monitoring Regulations

Rev. Proc. 2019-17 General Public Use Requirements

T.D. 9850 Changes to Final Regulations under 1.42-10

*Interpreting the Average Income Test, Part 1*  
(An article by Grace Robertson and Mark Shelburne reprinted from the Novogradac Journal of Tax Credits, March 2019)

*Interpreting the Average Income Test, Part 2*  
(An article by Grace Robertson and Mark Shelburne reprinted from the Novogradac Journal of Tax Credits, April 2019)


TAM 95-28002 (03/31/95) Combining 9% and 4% Project

IRS Notice 88-91 (Supports a condominium as a separate building for purpose of IRC Sec. 42)

PLR 201103006 (Multiple condominiums treated as one building for tax purposes)

Excerpt from Income Tax Regulation 1.704-1(b)(2)  
(covering Substantial Economic Effect and Substantiality)