First Year Tax Credits and Tax Credit Recapture

Today's instructor:

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First Year Tax Credit Calculation
Calculating Credits

Eligible Basis  
\[ \text{Eligible Basis} \times \text{DDA/QCT} \times \text{Applicable Fraction} \]

\[ 1,282,051 \times 130\% \times \frac{1,666,666}{\text{Eligible Basis}} \]
### Building A

**Applicable Fraction (LIHOP)**

- **Unit Fraction:** 80%
- **Floor Space Fraction:** 85%

#### Low-income units

#### Market-rate units

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### Building A

**Applicable Fraction (LIHOP)**

- **Unit Fraction:** 90%
- **Floor Space Fraction:** 80%

#### Low-income units

#### Market-rate units

---

### Calculating Credits

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible Basis</td>
<td>1,282,051</td>
</tr>
<tr>
<td>( \times \text{DDA/QCT} )</td>
<td>130 %</td>
</tr>
<tr>
<td>EB adj for DDA/QCT</td>
<td>1,666,666</td>
</tr>
<tr>
<td>( \times \text{Applicable Fraction} )</td>
<td>80 %</td>
</tr>
<tr>
<td>Qualified Basis</td>
<td>1,333,333</td>
</tr>
<tr>
<td>( \times \text{Tax Credit Percentage} )</td>
<td>9 %</td>
</tr>
<tr>
<td>Annual LIHTCs</td>
<td>120,000</td>
</tr>
<tr>
<td>( \times \text{Ten Years} )</td>
<td>10</td>
</tr>
<tr>
<td>Total LIHTCs</td>
<td>1,200,000</td>
</tr>
</tbody>
</table>
**Financing Method**

<table>
<thead>
<tr>
<th></th>
<th>New Construction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Federally Subsidized (Perm Loan)</td>
<td>9% credits</td>
</tr>
<tr>
<td>Federally Subsidized (TE bonds)</td>
<td>4% credits</td>
</tr>
</tbody>
</table>

**New Construction Acq/Rehab**

<table>
<thead>
<tr>
<th>Construction Method</th>
<th>9%</th>
<th>3.21% / 9%</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.28%</td>
<td></td>
<td>3.21% / 3.28%</td>
</tr>
</tbody>
</table>

**New Construction**

1. 4%
2. 9%
3. 4%
4. 9%

**Acq/Rehab**

1. 4%
2. 4%
3. 9%
4. 9%
Calculating Credits

<table>
<thead>
<tr>
<th>Description</th>
<th>No tax-exempt bonds</th>
<th>Financed in part w/ tax-exempt bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible Basis</td>
<td>1,282,051</td>
<td>1,282,051</td>
</tr>
<tr>
<td>x DDA/QCT</td>
<td>130 %</td>
<td>130 %</td>
</tr>
<tr>
<td>EB adj for DDA/QCT</td>
<td>1,666,666</td>
<td>1,666,666</td>
</tr>
<tr>
<td>x Applicable Fraction</td>
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<td>80 %</td>
</tr>
<tr>
<td>Qualified Basis</td>
<td>1,333,333</td>
<td>1,333,333</td>
</tr>
<tr>
<td>x Tax Credit Percentage</td>
<td>9 %</td>
<td>3.32 %</td>
</tr>
<tr>
<td>Annual LIHTCs</td>
<td>120,000</td>
<td>120,000</td>
</tr>
<tr>
<td>x Ten Years</td>
<td>10 x 10</td>
<td>10 x 10</td>
</tr>
<tr>
<td>Total LIHTCs</td>
<td>1,200,000</td>
<td></td>
</tr>
</tbody>
</table>

Financed in part w/ tax-exempt bonds:

<table>
<thead>
<tr>
<th>Description</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible Basis</td>
<td>1,282,051</td>
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</tr>
<tr>
<td>x DDA/QCT</td>
<td>130 %</td>
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</tr>
<tr>
<td>EB adj for DDA/QCT</td>
<td>1,666,666</td>
<td>1,666,666</td>
</tr>
<tr>
<td>x Applicable Fraction</td>
<td>80 %</td>
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<td>1,333,333</td>
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</tr>
<tr>
<td>Total LIHTCs</td>
<td>1,200,000</td>
<td></td>
</tr>
</tbody>
</table>

Qualifying the Project

**First year is critical:**

- Minimum set-aside must be met in first year
- Should meet 100% of LIHTC unit target at close of first year to avoid taking 2/3 credits
- Consider deferring credits one year if not 100% at end of first year
QUALIFYING THE UNIT

IRS

INCOME LIMITATIONS IRC§42(g)(1)
RENT LIMITATIONS IRC§42(g)(2)
SUITABLE FOR OCCUPANCY IRC§42(i)(3)

When does a unit start to count as “low-income qualified”? 

- The unit must be “in service” for a full month
- Must have been initially leased up to a low-income-qualified household (at proper rent level)...
- ...as of the last day of the month

How many credits can you claim in YEAR 1?
Month Counts?

Yes  No

Unit placed in service

Initial lease up

Initial Lease Up

(Year 1)

<table>
<thead>
<tr>
<th>Month</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>13</td>
<td>14</td>
<td>15</td>
<td>16</td>
<td>17</td>
<td>18</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>20</td>
<td>21</td>
<td>22</td>
<td>23</td>
<td>24</td>
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<td></td>
<td>27</td>
<td>28</td>
<td>29</td>
<td>30</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

JFMAMJASOND

100%

90%

80%

70%

60%

50%

40%

30%

20%

10%

Year 1 12/31

Floor Space Fraction = 6,600 sq. ft.

Unit Fraction = 10

Placed in Service (June 3rd)

6,600 sq. ft. = 600 sq. ft.

Tax Credit App. Form 8609

300 sq. ft.

1,000 sq. ft.

2,000 sq. ft.

3,000 sq. ft.

4,000 sq. ft.

5,000 sq. ft.

6,000 sq. ft.
Calculating Credits

| Eligible Basis | 1,282,051 |
| 1,282,051 | DDA/QCT | x | 130% |
| 1,666,666 | EB adj for DDA/QCT | x | 80% | 27.95% |
| 1,383,333 | Qualified Basis | x | 9% | 27.95% |
| 120,900 | Annual LIHTCs |

Floor Space Fraction

J F M A M J J A S O N D

Year 1

6,600 sq ft

1 BDR

720 sq ft

1 BDR

600 sq ft

1 BDR

4,680 sq ft

80%

1 BDR

5,280 sq ft

2 BDR

600 sq ft

1 BDR

6,600 sq ft

2 BDR

600 sq ft

1 BDR

600 sq ft

1 BDR

600 sq ft

1 BDR

600 sq ft

1 BDR

600 sq ft

1 BDR

5,280 sq ft

70%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%

1 BDR

5,280 sq ft

80%
What if you don’t reach your applicable fraction target by the end of the first year?

315.45% ÷ 12 = 26.29%
Calculating Credits

Eligible Basis: 1,282,051  
\times \text{DDA/QCT} \quad \times \quad 130\%

EB adj for DDA/QCT: 1,666,666

\times \text{Applicable Fraction} \quad \times \quad \text{EB adj for DDA/QCT}\%

Qualified Basis: 468,888

\times \text{Tax Credit Percentage} \quad \times \quad 9\%

Annual LIHTCs: 41,925

315.45\% \div 12 = 26.29\%
### Calculating Credits

<table>
<thead>
<tr>
<th></th>
<th>End of Year 1</th>
<th>Form 8609</th>
<th>Shortfall in Qualified Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible Basis</td>
<td>1,282,051</td>
<td>1,282,051</td>
<td></td>
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<tr>
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<td></td>
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<td>1,666,666</td>
<td></td>
</tr>
<tr>
<td>x Applicable Fraction</td>
<td></td>
<td>x 70%</td>
<td></td>
</tr>
<tr>
<td>Qualified Basis</td>
<td>1,166,666</td>
<td>1,333,333</td>
<td>166,667</td>
</tr>
<tr>
<td>x Tax Credit Percentage</td>
<td></td>
<td>x 9%</td>
<td></td>
</tr>
<tr>
<td>Annual LIHTCs</td>
<td><strong>105,000</strong></td>
<td><strong>120,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

### Diagram

- **$1.2 mil** ($120k / yr)
- **$1.05 mil** ($105k / yr)
- **$65,665** ($105k - $39,435)

### Table

- **Year 1**: $150,000
- **Year 2**: $150,000
- **Year 3**: $150,000
- **Year 4**: $150,000
- **Year 5**: $150,000
- **Year 6**: $150,000
- **Year 7**: $150,000
- **Year 8**: $150,000
- **Year 9**: $150,000
- **Year 10**: $150,000
- **Year 11**: $150,000

### Calculating Credits

<table>
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<tr>
<td>Annual LIHTCs</td>
<td><strong>105,000</strong></td>
<td><strong>120,000</strong></td>
<td></td>
</tr>
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</table>

### Diagram

- **$1.2 mil** ($120k / yr)
- **$1.05 mil** ($105k / yr)
- **$65,665** ($105k - $39,435)
Having some 15-year credits is not the end of the world...

...but if a partnership is WELL BELOW making its 12/31 applicable fraction...
...it might make financial sense to defer the credit period by one year rather than having too many 15-year credits.

What if you don’t achieve minimum set-aside by the end of the year the building is placed in service?
What if you do not receive the 8609s by the tax filing deadline?

What if you don’t receive the 8609s by the tax filing deadline?

• 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
  2. that the failure to complete the IRC §42(l)(1) certification was not due to willful negligence.

Source: Grace Robertson, “IRC §42(l)(1): Owner’s Certification with Respect to the First Year of the Credit Period” Low Income Housing Credit Newsletter, July 2008
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.

• Questions to consider

• Factors to consider

Willful Negligence

• Under Treas. Reg 1.6662-3(b), “willful neglect” is:

If the taxpayer cannot complete the IRC §42(l)(1) certification during the IRS audit

• The entire credit should be disallowed in all years open by statute.

• Determine whether the on-going delay in completing the IRC 42(l)(1) certification is due to reasonable cause.

• The examination should include verification of the Eligible Basis, Set-Aside for Eligible Percentage, and Minimum Set-Aside for the first year of the credit period. The examination process is then to determine whether the taxpayer is allowed to claim the credit in all years before the IRC §42(l)(1) certification is completed.
Outline

- The 8823 process
- Calculating recapture and loss of credits
- Special recapture rules and credit loss rules for:
  - Casualty loss
  - Federally declared disaster areas
- Correcting noncompliance
- Impact of recapture to the fund/investor
Major documents referenced during today’s town hall...

Form 8823

8823 Guide

The 8823 Process

State Agency Compliance Inspections
**Four questions:**

**WHO** performs the inspections?

**WHEN** must they review?

**WHAT** must they review?

**WHAT** must they report?
Four questions:

WHO performs the inspections?

WHEN must they review?

WHAT must they review?

WHAT must they report?

For at least 20% of the low-income units:

• Physical inspection of the units
• Review of income certifications and supporting documentation
• Review of rent records for existing households

NOTE:

ALL noncompliance found must be reported to the IRS on Form 8823 (regardless of whether the item was later corrected) UNLESS:

A. Noncompliance issues were identified and corrected by the owner prior to notification of the upcoming review by the state agency; OR...

B. Noncompliance issues are related to state requirements that are in excess of the Federal requirements.
Example State Agency Review Timeline

Initial notification letter of audit

Extended Correction Period Correction period

1/15/12
2/1/12
3/1/12
6/1/12
9/1/12
10/15/12

Site visit

Form 8823 issued

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Calculating Recapture and Loss of Credits

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Calculating Recapture

Eligible Basis 6,250,000
x Applicable Fraction x 80%
Qualified Basis 5,000,000
x Tax Credit Percentage x 9%
Annual LIHTCs 450,000
Calculating Recapture

Eligible Bass: 6,250,000

x Applicable Fraction: 5%

Quarterly/Annual Loss: 3,000,000

x Tax Credit Percentage: 5%

Annual LINTCcs: 450,000

• Casualty loss
• Reconfiguring space
• Disrepair
• Building disposition

Over-income tenants
• Rent too high

• Violate Available Unit Rule, Full-Time Student Rule, Vacant Unit Rule

Calculating Recapture

Eligible Bass: 6,250,000

x Applicable Fraction: 5%

Quarterly/Annual Loss: 3,000,000

x Tax Credit Percentage: 5%

Annual LINTCcs: 450,000

• Casualty loss
• Reconfiguring space
• Disrepair
• Building disposition

Over-income tenants
• Rent too high

• Violate Available Unit Rule, Full-Time Student Rule, Vacant Unit Rule

Calculating Recapture

Eligible Bass: 6,250,000

x Applicable Fraction: 5%

Quarterly/Annual Loss: 3,000,000

x Tax Credit Percentage: 5%

Annual LINTCcs: 450,000

• Casualty loss
• Reconfiguring space
• Disrepair
• Building disposition

Over-income tenants
• Rent too high

• Violate Available Unit Rule, Full-Time Student Rule, Vacant Unit Rule

Calculating Recapture

Eligible Bass: 6,250,000

x Applicable Fraction: 5%

Quarterly/Annual Loss: 3,000,000

x Tax Credit Percentage: 5%

Year 1: 12, 13, 14, 15

210k, 105k

Low-Income Qualified Units
Market-Rate Units

Credits claimed
Credits earned
Credits unearned
Recapture

450k

6.25%

plus Interest

Year
### Calculating Recapture

<table>
<thead>
<tr>
<th>Building Unit Damage</th>
<th>Recapture of previously claimed credits?</th>
<th>Loss of current-year credits?</th>
</tr>
</thead>
<tbody>
<tr>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>NO</td>
<td>NO</td>
<td>YES</td>
</tr>
</tbody>
</table>

| Casualty              | NO                                       | YES                          |

| In Federally Declared Disaster Area | NO | NO | NO |

#### Correcting Noncompliance

"I declare this a Disaster Area!"
Owners and operators of low income housing projects on which a credit has been claimed must correct any noncompliance with the set-aside requirement or with a reduction in qualified basis within a reasonable period after the noncompliance is discovered or reasonably should have been discovered. If any noncompliance is corrected within a reasonable period, there is no recapture.

KEY:
Always look at the close of the year. If a unit is out of compliance on December 31, you lose credits for that entire year!!!
Conversely…

And no recapture!

Credits OK (for all of 2011)

*Nonetheless, some noncompliance items cannot be retroactively corrected (i.e., over-income tenants, overcharging rents, etc.). If they are present as of the close of the year, there still may be loss of credits and recapture.
Information from Partnership

- Schedule K-1, Line 20G
- Address of building(s) with recapture
- Building Identification Number (BIN) for each building with recapture
- Placed in Service Date for each building with recapture
- Amount of recapture per BIN