

**First Year Tax Credits and Tax Credit Recapture**

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Today's instructor:

**Stacey Stewart**  
Partner – Dover Office  
Novogradac & Company LLP  
stacey.stewart@novoco.com



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**First Year Tax Credit Calculation**



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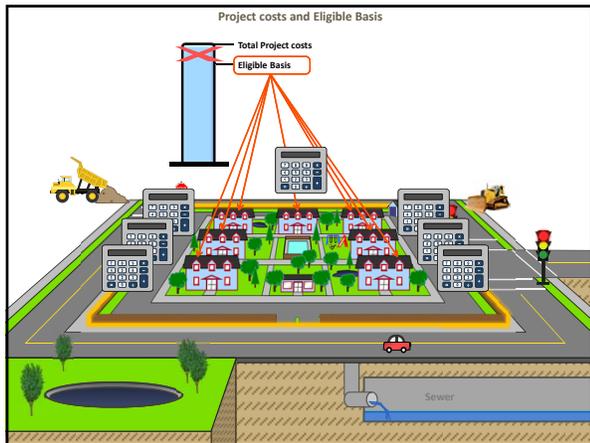
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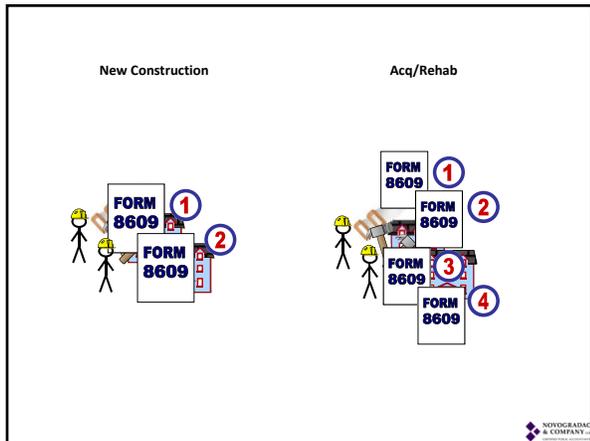
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### Calculating Credits

Eligible Basis	1,282,051
x DDA/QCT	x 130 %
EB adj for DDA/QCT	1,666,666
x Applicable Fraction	

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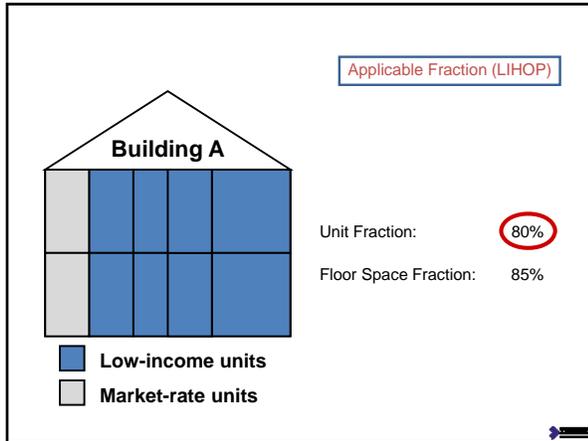
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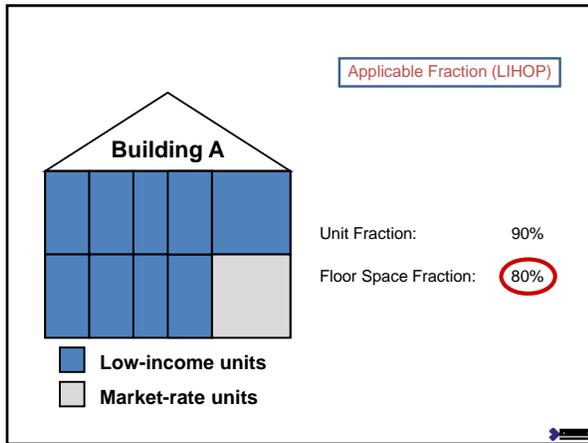
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### Calculating Credits

Eligible Basis	1,282,051
x DDA/QCT	x 130 %
EB adj for DDA/QCT	1,666,666
x Applicable Fraction	x 80 %
Qualified Basis	1,333,333
x Tax Credit Percentage	x 9 %
Annual LIHTCs	120,000
x Ten Years	x 10
Total LIHTCs	1,200,000

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Financing Method		New Construction
	Non-Federally Subsidized (Perm Loan)	9% credits
	Federally Subsidized (TE bonds)	4% credits

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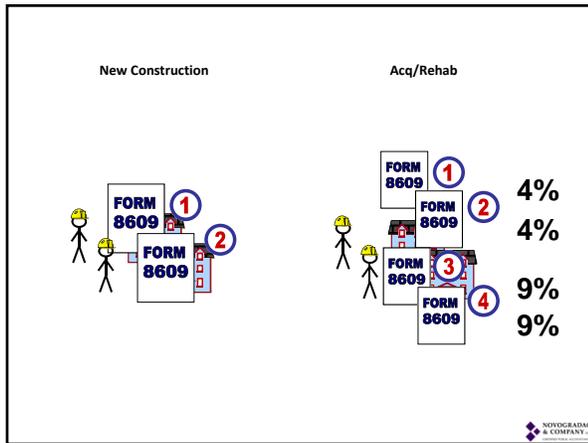
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		Construction Method	
		New Constr.	Acq/Rehab
Financing Method	Non-volume cap-bond debt	9%	3.21%/9%
	"Federally Subsidized"	3.28%	3.21%/3.28%

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**Calculating Credits**

	No tax-exempt bonds	Financed in part w/ tax-exempt bonds
Eligible Basis	1,282,051	
x DDA/QCT	x 130 %	
EB adj for DDA/QCT	1,666,666	
x Applicable Fraction	x 80 %	
Qualified Basis	1,333,333	
x Tax Credit Percentage	x <del>9 %</del>	x 3.32 %
Annual LIHTCs	120,000	44,267
x Ten Years	x 10	x 10
Total LIHTCs	1,200,000	442,670

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**Calculating Credits**

Eligible Basis	1,282,051	
x DDA/QCT	x 130 %	
EB adj for DDA/QCT	1,666,666	
x Applicable Fraction	x 80 %	
Qualified Basis	1,333,333	
x Tax Credit Percentage	x 9 %	
Annual LIHTCs	120,000	
x Ten Years	x 10	
Total LIHTCs	1,200,000	

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**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

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## QUALIFYING THE UNIT

### IRS

INCOME LIMITATIONS IRC§42(g)(1)

RENT LIMITATIONS IRC§42(g)(2)

SUITABLE FOR OCCUPANCY IRC§42(i)(3)

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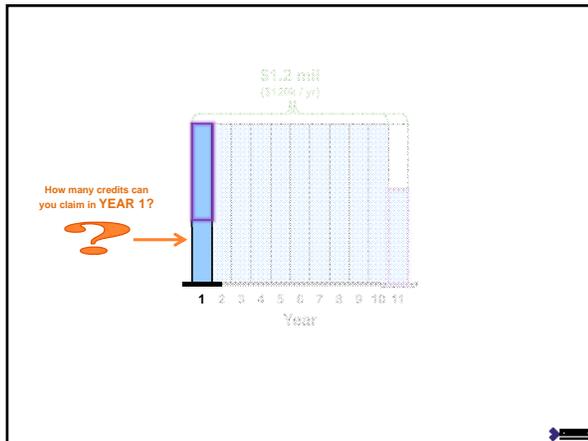
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### When does a unit start to *count* as “low-income qualified”?

- 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

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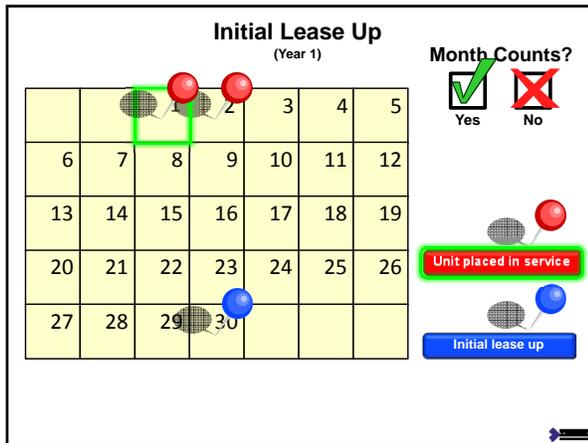
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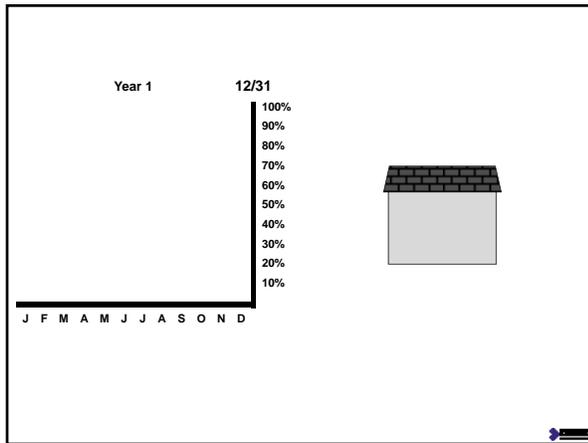
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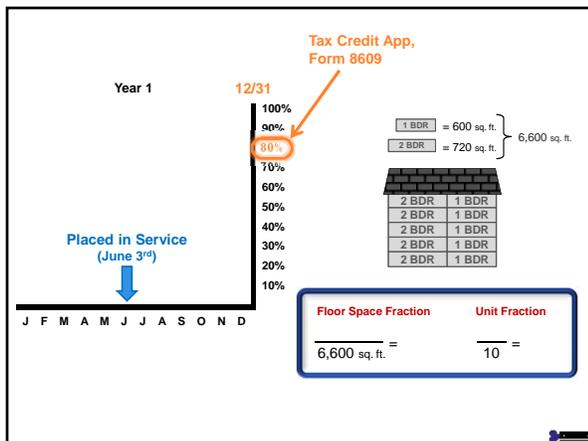
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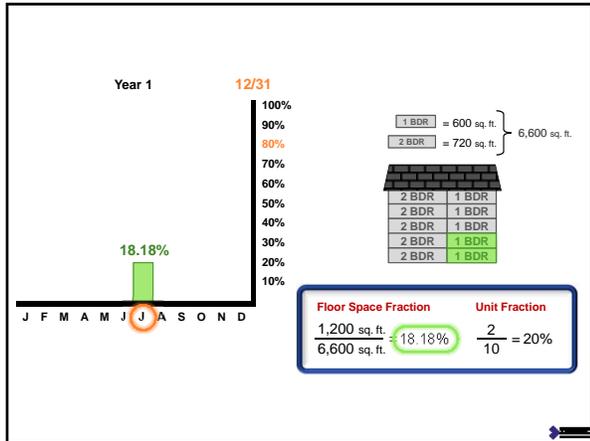
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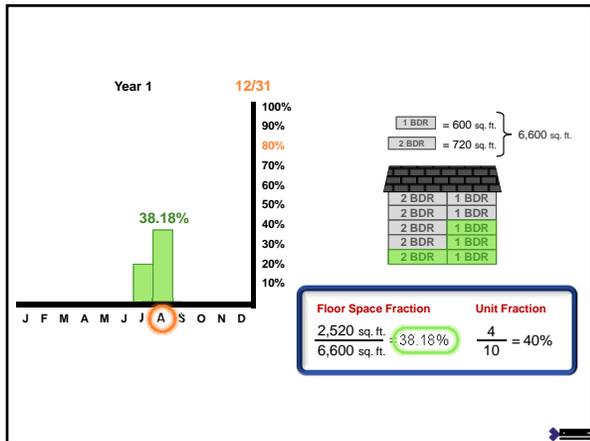
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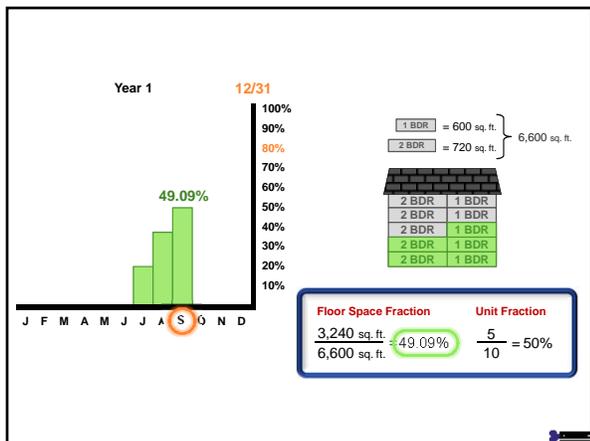
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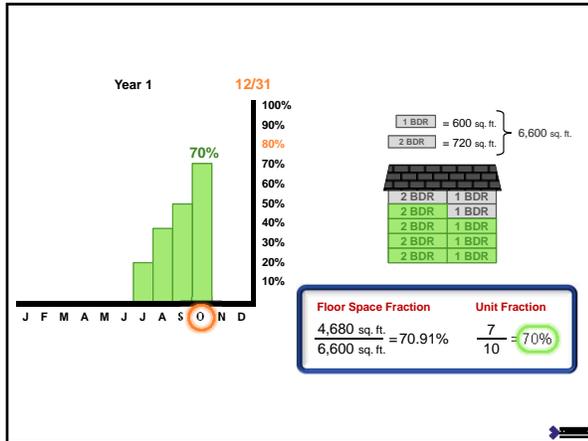
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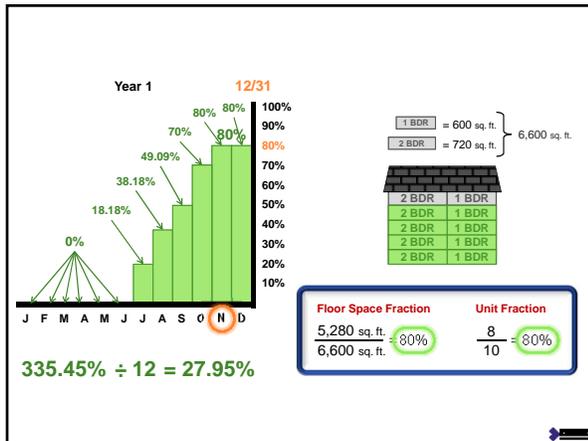
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### Calculating Credits

Eligible Basis	1,282,051	
x DDA/QCT	x 130%	
EB adj for DDA/QCT	1,666,666	
<i>First Year</i> x Applicable Fraction	x <del>80%</del> 27.95%	
Qualified Basis	1,383,833	
x Tax Credit Percentage	x 9%	
Annual LIHTCs	120,006	

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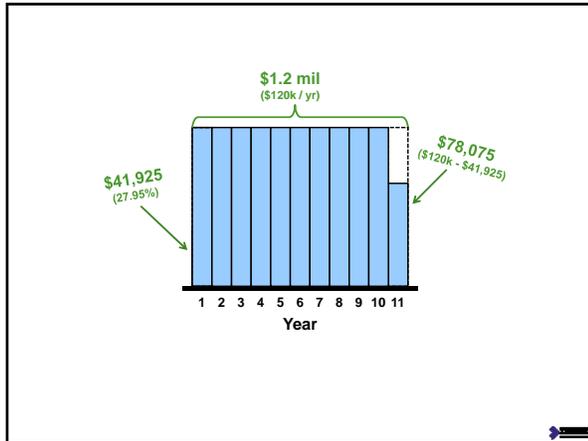
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**What if you don't reach your applicable fraction target by the end of the first year?**

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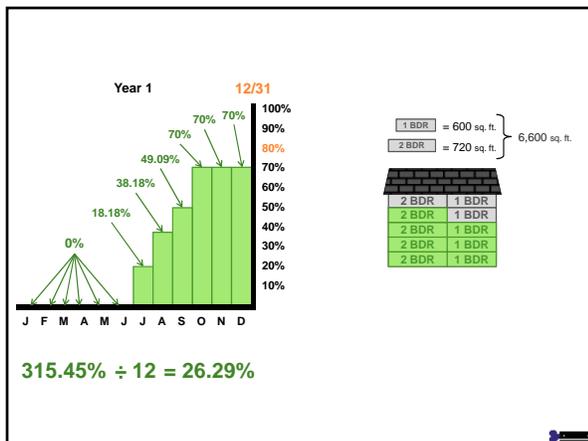
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### Calculating Credits

Eligible Basis	1,282,051	
x DDA/QCT	x 130%	
EB adj for DDA/QCT	1,666,666	
<i>First Year</i> x Applicable Fraction	x <del>27.95%</del> 26.29%	
Qualified Basis	<b>466,888</b>	
x Tax Credit Percentage	x 9%	
Annual LIHTCs	<b>41,925</b>	

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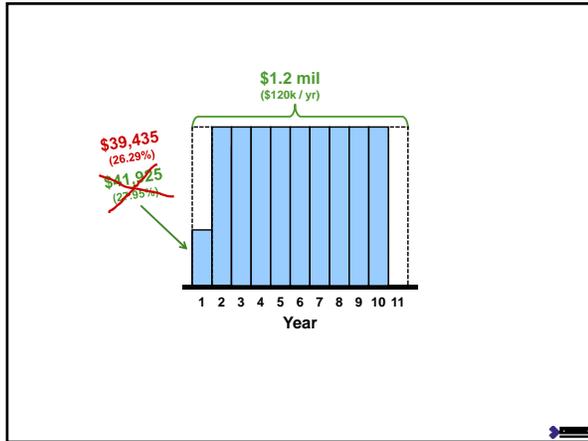
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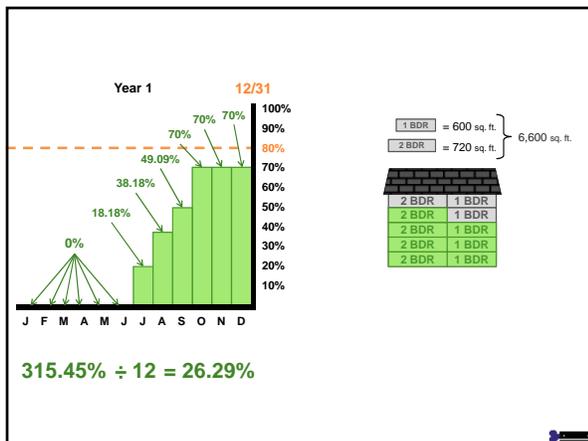
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### Calculating Credits

	End of Year 1	Form 8609
Eligible Basis	1,282,051	1,282,051
x DDA/QCT	x 130%	x 130%
EB adj for DDA/QCT	1,666,666	1,666,666
x Applicable Fraction	x 70%	x 80%
Qualified Basis	1,166,666	1,333,333
x Tax Credit Percentage	x 9%	x 9%
Annual LIHTCs	<b>105,000</b>	<b>120,000</b>

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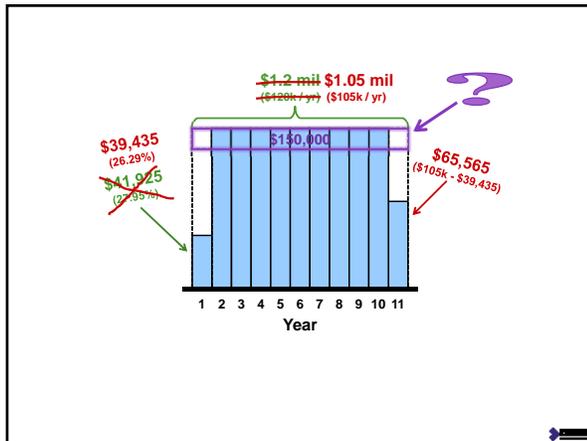
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### Calculating Credits

	End of Year 1	Form 8609	Shortfall in Qualified Basis
Eligible Basis	1,282,051	1,282,051	
x DDA/QCT	x 130%	x 130%	
EB adj for DDA/QCT	1,666,666	1,666,666	
x Applicable Fraction	x 70%	x 80%	
Qualified Basis	1,166,666	1,333,333	<b>166,667</b>
x Tax Credit Percentage	x 9%	x 9%	x 6%
Annual LIHTCs	<b>105,000</b>	<b>120,000</b>	10,000
			x 15
			150,000

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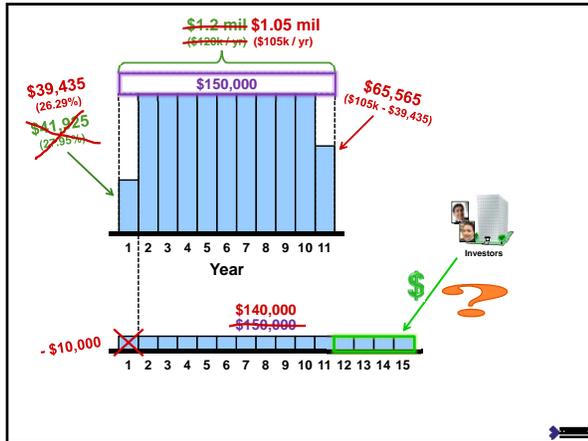
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Having some 15-year credits is not the end of the world...

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...it might make financial sense to defer the credit period by one year rather than having too many 15-year credits.

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What if you don't achieve minimum set-aside by the end of the year the building is placed in service?

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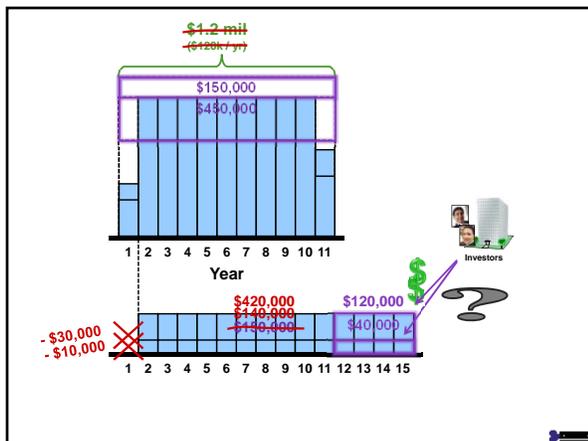
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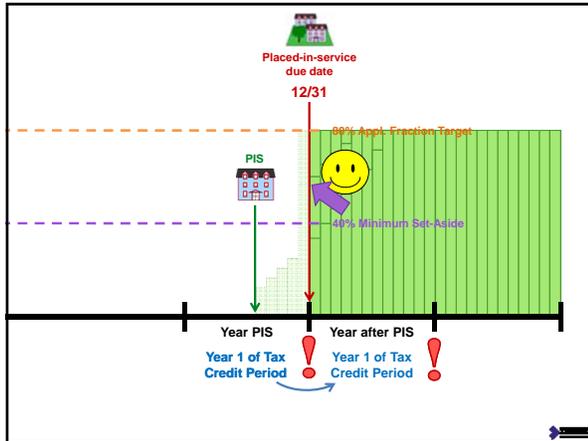
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**What if you do not receive the 8609s by the tax filing deadline?**

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**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:
  - a reasonable cause for not timely completing the IRC §42(l)(1) certification
  - 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.




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### 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**



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

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### Willful Negligence

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



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

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### 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 and Minimum t period
- If the failure t not due to a r neglect, the e years open by year before the IRC §42(l)(1) certification is completed.



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

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# Tax Credit Recapture

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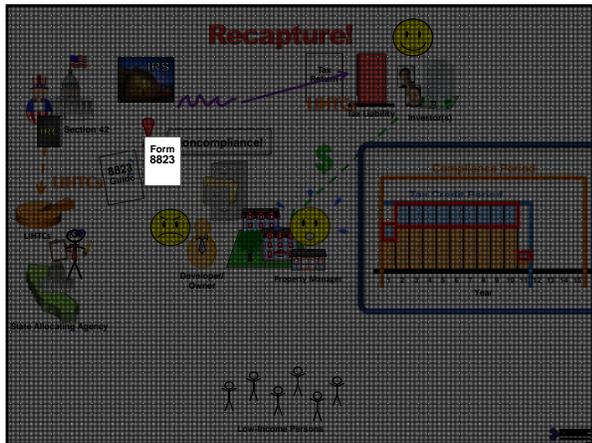
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- ## Outline
- The 8823 process
  - Calculating recapture and loss of credits
  - Special recapture rules and credit loss rules for:
    - Casualty loss
    - Federally declared disaster areas
  - Correcting noncompliance
  - Impact of recapture to the fund/investor

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Major documents referenced during today's town hall...



**Form 8823**  
Low Income Housing Credit Agencies  
Report of Noncompliance or Building Disposition



**8823 Guide**

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## The 8823 Process

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## State Agency Compliance Inspections

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**Four questions:**  
**WHO** performs the inspections?  
**WHEN** must they review?  
**WHAT** must they review?  
**WHAT** must they report?

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**Four questions:**  
**WHO** performs the inspections?  
**WHEN** must they review?  
**WHAT** must they review?  
**WHAT** must they report?

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**Four questions:**  
**WHO** performs the inspections?  
**WHEN** must they review?  
**WHAT** must they review?  
**WHAT** must they report?

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**EXTENSIVE noncompliance!**

**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

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**Four questions:**

- WHO performs the inspections?
- WHEN must they review?
- WHAT must they review?
- WHAT must they report?

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**Form 8823**

**Four questions:**

- WHO performs the inspections?
- WHEN must they review?
- WHAT must they review?
- WHAT must they report?

**NOTE:**

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

- Noncompliance issues were identified and corrected by the owner **prior to notification** of the upcoming review by the state agency, **OR**...
- Noncompliance issues are related to **state requirements** that are in excess of the Federal requirements.

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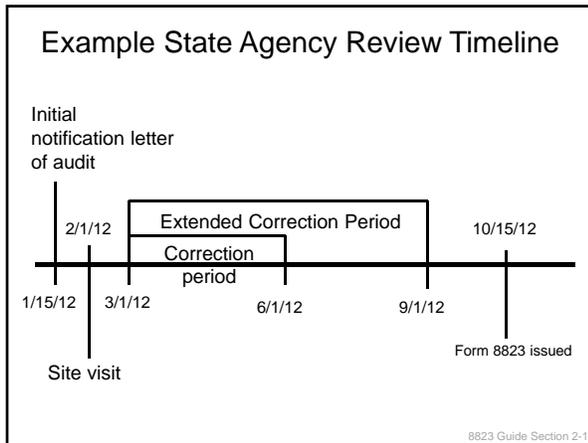
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## Calculating Recapture and Loss of Credits

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### Calculating Recapture

Eligible Basis	6,250,000	↓
x Applicable Fraction	x 80%	↓
<b>Qualified Basis</b>	<b>5,000,000</b>	↓
x Tax Credit Percentage	x 9%	
<b>Annual LIHTCs</b>	<b>450,000</b>	

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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			

- Casualty loss
- Reconfiguring space
- Disrepair
- Building disposition
- Over-income tenants
- Bad files
- Rent too high
- Violate Available Unit Rule, Full-Time Student Rule, Vacant Unit Rule

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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			

- Casualty loss
- Reconfiguring space
- Disrepair
- Building disposition
- Over-income tenants
- Bad files
- Rent too high
- Violate Available Unit Rule, Full-Time Student Rule, Vacant Unit Rule

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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			

- Casualty loss
- Reconfiguring space
- Disrepair
- Building disposition
- Over-income tenants
- Bad files
- Rent too high
- Violate Available Unit Rule, Full-Time Student Rule, Vacant Unit Rule



**6.25%**

- Low-Income Qualified Units
- Market-Rate Units
- Units out of compliance

\$ 450k  
x 6.25%  
\$ 28,125

Credits claimed	\$1,215,000
Credits earned	- 810,000
Credits unearned	405,000
QB reduction	x 6.25%
<b>Recapture</b>	<b>\$25,313</b>

plus interest

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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.

- Joint Committee Report on the LIHTC and General Explanation on the LIHTC



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Under section 42(f)(1), a building's credit period is the period of 10 years (120 months) beginning with the first day of the taxable year in which the building is placed in service, or the succeeding taxable year if the election under section 42(f)(1)(B) is made. Credit is determined on a monthly basis only for the first year of the credit period under section 42(f)(2)(A) and additions to qualified basis under section 42(f)(3)(B). Otherwise, credit is claimed on an annual basis. Other than sections 42(f)(2)(A) and 42(f)(2)(B), there is no authority for disallowing credits on a monthly basis. If a building is damaged by a casualty and fully restored and rented to low-income tenants within the same taxable year, then there is no recapture and no loss of credits. Thus, under the above facts and assumptions, the owner may claim credits on the 25 low-income units for the 2007 taxable year. We also conclude that if the owner had failed to restore the building by December 31, 2007, no credits would be allowed for the entire taxable year of 2007, even if the reasonable period (or reasonable restoration period) to the restore the building extends into 2008.

Office of Chief Counsel, Internal Revenue Service  
Memorandum No: 200913012

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**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!!!



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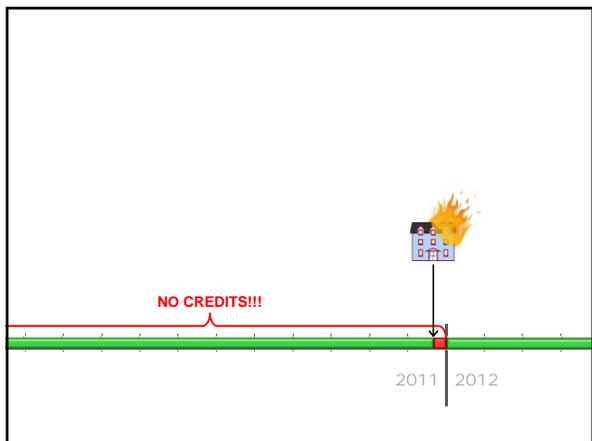
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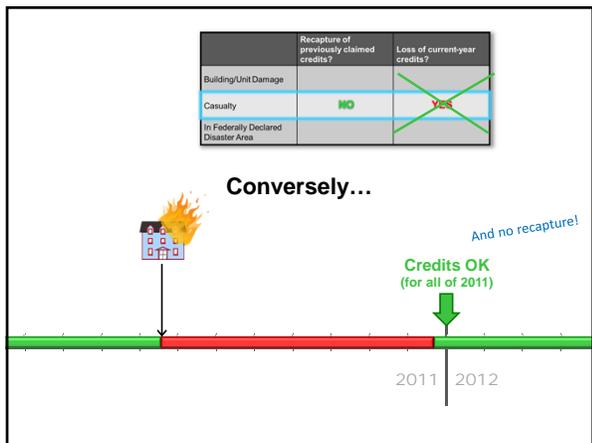
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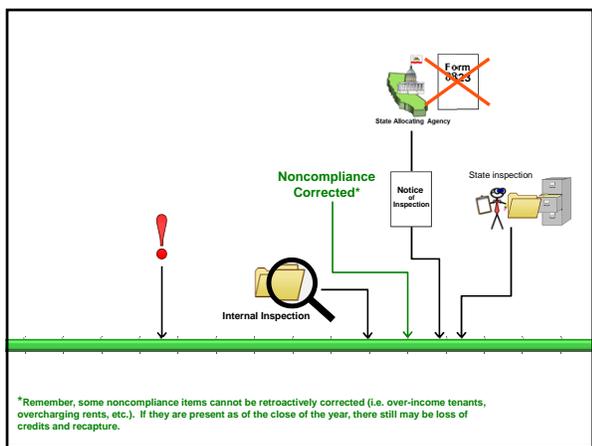
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# Impact of recapture to the fund/investor

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## 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



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**First Year Tax Credits and Tax Credit Recapture**

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[www.novoco.com/products](http://www.novoco.com/products)

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