



Back to Basics: Acquisition Rehab Tax Credits

by Scott Michael Dunn, CEO of Costello Compliance

In this series, we have covered the basics of tax credit compliance and how to research answers to questions tax credit professionals have in their daily practice. In this article, the focus will be on compliance for acquisition/rehab (acq/rehab) properties.

All tax credit properties are complex. They can be likened to a machine with many moving parts to run smoothly. Existing buildings that are acquired and rehabbed with tax credits involve additional parts, including communicating with the existing population, construction around them and unit transfers.

From a compliance standpoint, there are also several complex issues to be aware of and incorporate into all the other moving parts of successful tax credit delivery. It becomes clear to seasoned professionals that there are several key differences in carrying out compliance for new construction as compared to acq/rehab properties. Understanding where these project types differ helps housing professionals avoid the confusion that can accompany acq/rehab compliance.

Two Credit Streams

The value of tax credits starts with depreciable costs spent on a residential building. The accounting term for these costs is the eligible basis for a building. New construction costs are a common basis for tax credits. Also, the costs to rehabilitate an existing building may be a basis for credits. Finally, the cost of acquiring an existing building can be used, as long as the building will also be rehabbed.

The costs that go into the eligible basis for the acquisition of an existing building are different from the costs for the rehab of the building, so each basis establishes a separate credit stream.

Each of these credit streams must be accounted for separately, so each building subject to acq/rehab will have two allocation forms 8609.

Applicable credit percentages may also differ between the credit streams. The rehab credits can have a 9% applicable credit percentage as long as the rehab is not financed with tax-exempt bonds. Acquisition credits, however, are always limited to a 4% credit, regardless of financing.

Tax Credit calculation:	Credit type		
	New construction	Acquisition	Rehabilitation
Eligible basis	Cost to construct building	Cost to acquire building	Cost to rehab building
X Applicable fraction	% of low-income units	% of low-income units	
= Qualified basis			
X Credit percentage	4% (bond) or 9%	4%	4% (bond) or 9%
= Annual tax credits			

Placing in-service and start of credits

A crucial difference between acq/rehab projects and new construction that can sometimes be confusing is how placed in-service dates and the start of credits work. Per IRS guidance, a tax credit building is placed in-service when it is ready for its intended purpose. For new construction, this is generally when a certificate of occupancy (COO) allows an owner to legally occupy the first unit in a building, with occupancy being the intended use of the building.

The issue date of the COO becomes important as a starting point. Leases and resident occupancy should not usually predate the placed in-service date for a new construction building. Also, tax credits cannot be claimed on a building until on or after its placed in-service date. For existing buildings that are occupied at acquisition, however, the building is ready for its intended occupancy purpose as of the acquisition; therefore, the placed in-service date is the date of acquisition.

The definition of placed in-service for rehab is based on an expenditure test (how much is spent), which involves time limits and minimum expenditures to establish the needed eligible basis for the rehab. The date is not necessarily directly related to when the rehab is completed or when all units are suitable for occupancy. Because of this, each acq/rehab building has two placed in-service dates — one for the acquisition and one for the rehab. Each date will show up on its respective 8609.

As with new construction, acq/rehab credits cannot be claimed until a building is placed in-service. In theory, this means that both credits could start as early as the acquisition is placed in-

service. However, if the rehab is placed in-service in a later year, then both credits will start as of the start of the year that the rehab places in-service.

Note that this is not the rehab placed in-service DATE, but rather it is the YEAR the rehab is placed in-service. Therefore, credits may start the later of the acquisition date or the start of the year the rehab is placed in-service. For example, if a building is acquired on Feb. 1, 2018, and the rehab is placed in-service (enough money is spent) by Nov. 17, 2018, both credits may be claimed starting Feb. 1, 2018. Alternatively, if the rehab was not placed in-service until March 13, 2019, both credits may begin the start of 2019.

With new construction, once a building is placed in-service, credit may either be claimed starting that year, or they may be deferred one year. This is also true for an acq/rehab project. However, the deferral option is based on the year the rehab is placed in-service, not acquisition.

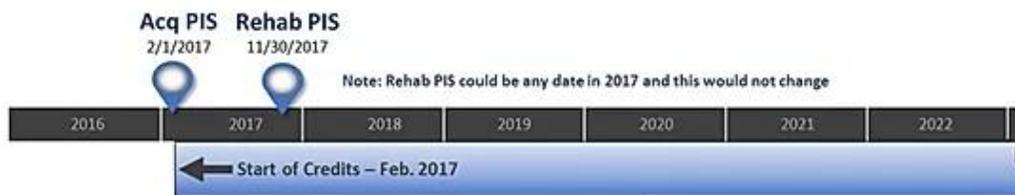
In the above scenario where the building was acquired in 2018, but the rehab was placed in-service in 2019, credits may be claimed in 2019 or deferred to 2020. Therefore, acquisition placed in-service may predate the start of credits by two or more years. This is crucially different from new construction, where the credits must be claimed no later than the year after placing in-service.

Examples: Credit “tack-back”

A building was acquired 3/10/2017 and the rehab was PIS 10/30/2018. Both credits may begin on 1/1/2018.



A building was acquired 2/1/2017 and the rehab was PIS 11/30/2017. Both credits may begin on 2/1/2017.



Qualifying Households [8823 Guide Chapter 4]

Although the claiming of credits is most sensitive to the year that the rehab is placed in-service, qualifying households for tax credits starts based on the acquisition date. For new construction, households are proven to qualify and then moved in. The move-in date becomes the effective date for the tenant certification, and all of the paperwork should pre-date that effective date.

In many existing buildings, however, in-place households may qualify at acquisition, but the IRS recognizes that it may take an owner some time to prove it after the acquisition. It allows that

any certification done 120 days after (or before) acquisition may have an effective date as of the acquisition placed in-service. Therefore, effective dates may predate the date the paperwork is completed and signed by up to 120 days, and still be compliant. Certs for households that were in place as of the acquisition date but were signed after the 120 days will have an effective date as of the date of the last household adult signature. Move-ins after acquisition will need to qualify and have an effective date as of move-in, as with any other move-ins.

In any case where credits are deferred after the year that people start occupying a building, those residents are still qualified for tax credit units once credits start, even if their income goes above the limits by the start of the first year credits are claimed. Because acquisition may predate the start of credits by two or more years (as discussed above), the initial certs may predate the start of credits by more time than is often seen with new construction projects. However, these households are still good for the start of credits as long as IRS safe harbor provisions are followed.

Example: 120-day acquisition grace period



As mentioned in the outset of this article, construction and dealing with the existing population provide a great deal of additional complexity not experienced with new construction. These are beyond the scope of this article. However, understanding the above principles goes a long way in assisting compliance professionals in designing a process that can successfully deliver tax credits on an acq/rehab project amid all the other “moving parts.”

Scott Michael Dunn is the CEO of Costello Compliance and Director of Policy for the Costello Companies. The Costello Companies are developers, builders and managers of affordable housing with clients throughout the country. They are headquartered in Sioux Falls, S.D. Scott Michael has served as part of the Technical Advisor Group on the HCCP Board of Governors for over a decade. He can be reached by email at sdunn@costelloco.com.