Wrapping Up 2020: Year-End Reporting

by Gary Kirkman, Director of Compliance Training

Let's face it — the year 2020 has been a whirlwind, and it seems that something new is presented for us to face every day. The IRS announced that Housing Finance Agencies (HFAs) do not have to complete monitoring reviews or inspections, and management companies do not have to complete recertifications for the period of April 1, 2020 – Dec. 31, 2020. Despite this announcement, management companies are not getting a "get out of jail free card" as it relates to noncompliance.

In the compliance world, tax credit housing providers all have something in common: a duty to provide affordable housing to qualified households. In doing so, companies must ensure that they follow the tax credit regulations when moving a household in, which will help make year-end something not to dread, but to look forward to. Honestly, I believe 2021 will be better.

The Treasury Department Regulation § 1.42-15 outlines areas that owners should be aware of when managing tax credit properties throughout the year because owners are ultimately responsible for maintaining program compliance.

This article looks at four areas to consider in preparation for the owner's taxable year-end:

- Minimum Set-Aside/Applicable Fraction
- Rent-Restricted Units
- Student Eligibility
- Cost-of-Living Adjustment

1. Minimum Set-Aside/Applicable Fraction

Two especially important areas to consider are the minimum set-aside (MSA) and applicable fraction.

The MSA is the percentage of units in a project that must be rented to qualified low-income households. In order for a project to be eligible to claim credits, the project must first meet the owner's elected MSA (i.e., 20-50%, 40-60%, Average Income or 25-60% for NYC only) by the required deadline for the first year of the credit period and then maintain the MSA throughout the 15-year compliance period. If the project achieved the MSA for the first year of the credit period but fails to meet the MSA at the close of any subsequent taxable year in the compliance period, then the entire credit is lost for that year.

The applicable fraction is the percentage of a building that houses the tax credit qualified households. Management wants to lease up as many units as possible before year-end to maximize first-year tax credits by having a higher applicable fraction. Units leased after the first year fall under the "two-thirds" or "15-year" credits, and generate a lower amount of credits annually than if those units were leased prior to year-end.

Let's take a look at two examples of the annual tax credit formula using the same eligible basis of $3.2 million and a 9% applicable percentage.

__Example #1__: *$3.2 million (Eligible Basis) × 95% (Applicable Fraction) = $3.04 million (Qualified Basis) × 9% (Applicable Percentage) = $273,600 (Annual Tax Credit)*

__Example #2:__ *$3.2 million (Eligible Basis) × 65% (Applicable Fraction) = $2.08 million (Qualified Basis) × 9% (Applicable Percentage) = $187,200 (Annual Tax Credit)*

As you can see, the higher applicable fraction results in more annual tax credits to be applied to the owner's tax liability, but having a lower applicable fraction results in lower annual tax credits that can be claimed (in these examples, $86,400 less).

For ongoing compliance, after the first year of the credit period, it is important to remember that any unit that has been determined to be out of compliance cannot be counted toward meeting

the MSA or counted in the numerator of the applicable fraction. Therefore, it is crucial that any identified issues of noncompliance have been corrected prior to year-end.

2. Rent-Restricted Units

In order for a unit to be in compliance with the LIHTC regulations, the gross rent charged cannot exceed the tax credit maximum rent limit. The gross rent takes into account the tenant paid rent, the utility allowance and any non-optional fees (fees that must be paid as a condition of occupancy).

Owners and management agents are reminded that, if the tenant is overcharged rent — even if the owner/management agent refunds the amount — the unit ceases to be considered a tax credit unit for the remainder of the owner's tax year and cannot be counted as a tax credit unit when determining the MSA/applicable fraction.

3. Student Eligibility

Even though the IRS announced that Housing Finance Agencies (HFAs) do not have to conduct any inspections, owners and management agents must still ensure that the households they move in are at or below the applicable income limits, and do not comprise full-time students, unless the household meets at least one of the five student exceptions.

With a lot of schools now offering online classes, it is important that owners and management agents understand how their state HFAs define an "educational organization" as it relates to their online classes.

Another item to note is that verification of student status is vital to ensure those "part-time" student households are truly part time so that compliance is being maintained.

4. Cost-of-Living Increases

As the end of the year quickly approaches, another area of concern when leasing to qualified households is the inclusion of any potential cost-of-living adjustments (COLA) that may be announced by the Social Security Administration.

It is vital, that should Social Security increase this year, the COLA increase is correctly calculated and used to anticipate a household's annual income as we move closer to the new year to ensure the household is truly at or below the applicable income limit.

In 2019, the Social Security Administration announced the 1.6% COLA increase for 2020. To anticipate the new benefit amount, owners and management agents had two options:

1. Multiply the current benefit amount by the COLA percentage, then add the increased amount to the current benefit amount.
   Example: $840 × 1.6% = $13.44 + $840 = $853.44 (anticipated monthly amount)

2. Multiply the current benefit amount by 1, plus the COLA percentage (expressed as a decimal).
   Example: $840 × 1.016 = $853.44 (anticipated monthly amount without the extra step outlined in #1)

Management should ensure that, if the Social Security Administration announces a COLA this year, it factors the increases into determining the household income as it applies to the move-in dates for the new household. If a COLA is announced in October for the 2021 calendar year, and an applicant wants to move in Nov. 1, two months would count at the old benefit amount and 10 months at the new benefit amount. If the applicant wants to move in on Dec. 1, anticipate annual income as one month at the old benefit amount and 11 months at the new benefit amount.

Make sure to maintain a copy of the COLA announcement in the household's file to support why the income was calculated in such a manner. Show how the calculation was achieved.

These four areas are just a few items to think about as we prepare to wrap up this year and prepare for the upcoming new year. It seems compliance never ends because what we do today can affect tomorrow!

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