What to Expect as Relief Measures Expire

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In response to the COVID-19-related declaration of a national emergency in March 2020, the Internal Revenue Service (IRS) released IRS Notice 2020-53, which was later extended in IRS Notice 2021-12, to provide temporary relief from various regulations for low-income housing tax credit and tax-exempt bond. Normalcy, at least with regards to compliance and compliance monitoring, returned Oct. 1, 2021.

While most of the relief in the notice expired Sept. 30, 2021, there are two pieces of relief under the notice that extended thru Dec. 31, 2021.

Placed-in-Service Deadline:

9% projects are expected to place in service no later than the end of the second calendar year after the year of the award. Failure to timely place building in service results in a complete loss of low-income housing credits (LIHCs). Part IV(C) of the notice provided that, if the placed-in-service deadline was the close of calendar year 2020, the deadline was postponed to 2021.

Example:

Taxpayer received a Carryover Allocation Agreement in 2018. The placed in-service deadline under §42(h)(1)(E)(i) is no later than Dec. 31, 2020 — the second calendar year after the year of award. Because of unforeseen challenges as a result of the pandemic, this project was not able to place in service by Dec. 31, 2020; because of the relief provided in this notice, that deadline was postponed to Dec. 31, 2021, thus saving the much-needed quality affordable housing.

Casualty Loss:

A casualty loss is defined as the damage, destruction or loss of property resulting from an identifiable event that is sudden, unexpected or unusual. Unlike other categories of noncompliance that have a correction period prescribed under Treasury Regulation §1.42(e)(4), casualty loss has a reasonable restoration period of two years at the discretion of the state housing finance agency.

If a building is restored within the reasonable restoration period, then the reduction in qualified basis that is a result of the loss does not trigger an event of recapture; however, no credit is allowed for the years in which the building is offline. If the damaged property cannot be restored by the end of the reasonable restoration period, then the building is subject to recapture of accelerated credit.

Part IV(D) of the notice provided that, if the reasonable restoration period ends on or after April 1, 2020, then that reasonable restoration period can be postponed by a period of one year from the original end date but not beyond Dec. 31, 2021.

Example:

A fire occurred Dec. 15, 2018, with a reasonable restoration period approved by the state housing finance agency that concludes Dec. 31, 2020. If the building is restored timely, by the end of 2020, it would result in a disallowance of credits for 2018 and 2019 but would not result in a recapture of the accelerated credits.

The taxpayer was unable to restore the building until March 1, 2021. Independent of the relief under Part IV(D), the taxpayer would be facing both the disallowance of credits for 2018, 2019 and now 2020, as well as recapture of all accelerated credits on the damaged units. With this relief, the reasonable restoration period can be postposed to Dec. 31, 2021. Under this fact

pattern, the taxpayer will still incur a disallowance of credits for 2018, 2019 and now in 2020, but because the building was restored before the end of the postposed restoration period, the recapture of accelerated credits would be mitigated.

As of Oct. 1, 2021, the following relief expired, and reacclimating may be challenging as we shift our focus from surviving the pandemic to the new normal. Understanding what expired and what may have changed during this period that affects how we operate is the key to success.

Annual Income Certifications:

Low-income units in projects that have non-LIHTC units are required to be income certified annually. The requirement to complete the annual income certification was waived under Part V(A) of the notice if it was due from April 1, 2020, through Sept. 30, 2021. Any annual income certification due as of Oct. 1, 2021, or later must be completed.

This annual income certification process is the same as the initial certification in respect to documenting household composition, income and student status. Failure to conduct this process is subject to the category of noncompliance Owner Failed to Correctly Complete or Document Tenant's Annual Income Recertification contemplated in Chapter 5 of the 8823 Guide. The need to assess a low-income unit's income annually is to ensure that there are always enough low-income units to maintain a building's applicable fraction. When the applicable fraction is not maintained, the building qualified basis is reduced, causing an even of disallowance and/or recapture.

If a low-income household is determined to be over-income at recertification, meaning the household has an income that exceeds the applicable income limitation of the unit, then the next available unit in the building of smaller or comparable size must be leased to low-income households until there are enough units to meet the building's applicable fraction without the

over-income household. Failure to follow this compliance provision is subject to a separate category of noncompliance Violations of the Available Unit Rule Under Section 42(g)(2)(D) as discussed in Chapter 14 of the Guide.

The intersection of these two events is contingent on timely and accurate assessment of a household's income. During the cover of relief, as the requirement to conduct the annual income certification was waived, the Available Unit Rule was rendered moot. Now that we are back to normal, it is important to remind ourselves what normal is. It is not just about the functionality of completing the annual income certification, but a reminder that the application of the annual income certification process has a systematic impact on the ability to comply with other, lesser known compliance requirements.

Common Areas and Amenities:

The amount of LIHC a building can generate is based on cost associated with the building (the eligible basis) and the portion of the building that is low income (the applicable fraction). Eligible basis may include the cost of facilities for use by tenants to the extent there is no separate fee for using the facilities and the facilities are available on a comparative basis to all tenants. The Eligible Basis of a property is reduced when space that originally qualified as residential rental property changes character or space that was originally designated for use by qualified tenants is no longer available to them. This event of noncompliance is cited under Change in Eligible Basis discussed in Chapter 8 of the Guide.

Once this event is report on IRS Form 8823, there is no path for correction, and the IRS Form 8823 will remain outstanding in perpetuity. These common areas and amenities were largely out of service during the pandemic as a result of health and safety concerns. Part V(C) of the Notice provided that:

> *"If an amenity or common area in a low-income building or project is temporarily unavailable or closed during some or all of the period from April 1, 2020, to September 30, 2021, and if the unavailability or closure is in response to the COVID-19 pandemic and not because of other noncompliance for § 42 purposes, then this temporary unavailability or closure does not result in a reduction of the eligible basis of the building."*

All common areas and amenities should now be open and in good physical condition. For example, a playground that was closed for more than a year because of the pandemic may have fallen into disrepair or a community room may have appliances that do not work. If these amenities and/or common areas are not operational, it could result in a reduction of eligible basis. Remember, reductions in eligible basis are not correctable under IRC Section 42.

Compliance Monitoring-:

Treasury Regulation §1.42-5 describes the minimum compliance monitoring requirements for each state housing finance agency (the "agency"). These requirements are contained in the agency's compliance monitoring plan with respect to how they will monitor and report noncompliance.

The first inspection must be completed no later than the second calendar year after the last building in the low-income project places in service. After the first inspection, the agency must conduct inspections at least once every three years throughout the extended use period. The requirement for agencies to conduct inspections that were due starting April 1, 2020, was waived through Sept. 30, 2021, under Part V(B) of the notice. As these provisions have expired, it is important to take a moment and remind ourselves of how agencies will conduct inspections.

Treasury Regulation §1.42-5 was amended in February 2019 where the deadline to incorporate these changes in their monitoring plans was Dec. 31, 2020 — meaning that, starting in January

2021, the manner in which agencies are to conduct inspections is different than how an agency would have conducted the same type of inspection prior to the change in the regulation. As these inspections have been suspended since April 2020, this results in a unique convergence of timing.

Number of Low-income Units:

The low-income unit selection remains local to the project election. Project, in this context, is the election made on line 8b of IRS Form 8609. The number of low-income units to be inspected is the **lesser** of 20% of low-income units in the project or the number listed in the table to Paragraph (C)(2)(III) found in in TR §1.42-5 as follows:

Number of Low-Income Units in the Low-Income Housing Project	Number of Low-Income Units Selected for Inspection or for Low-Income Certification Review (Minimum Unit Sample Size)
1	1
2	2
3	3
4	4
5-6	5
7	6
8-9	7
10-11	8
12-13	9
14-16	10

17-18	11
19-21	12
22-25	13
26-29	14
30-34	15
35-40	16
41-47	17
48-56	18
57-67	19
68-81	20
82-101	21
102-130	22
131-175	23
176-257	24
258-449	25
450-1,461	26
1,462-9,999	27

For projects with between one and 105 low-income units, the number of low-income units inspected will be 20% rounded up.

For projects with more than 111 low-income units, the number of low-income units inspected is found in the chart.

For projects with between 106-110 low-income units, the 20% and the chart result in the same number of low-income units to be inspected.

Random Selection:

Once the number of low-income units to be inspected is identified, selection of the units is next. The manner in which the agency selects the units must be random. In the IRS's Summary of Comments and Explanation of Provisions (84 FR 6076), "*The statistical validity of inspecting only a sample of the low-income units in a project depends on the sample being random and representative*."

The current guidance recognizes that review of tenant file certifications and a physical inspection may not occur at the same time. In such a case, the agency must select units for the tenant file review randomly and separately select units for the physical inspection.

All Building Rule:

Specific to a physical inspection, in the buildings where a unit was not randomly selected, the building itself must still be inspected. In the IRS's Summary of Comments and Explanation of Provisions (84 FR 6076):

> *Under the all-buildings rule, if the randomly selected minimum number of low-income units to be inspected fails to include at least one unit in one or more buildings in a project, then an Agency may satisfy the requirement by inspecting some aspect of each omitted building. These aspects might include the building exterior, common area, HVAC system, etc. In the absence of HUD oversight, requiring that all-buildings be inspected serves as a quality control mechanism.*

In the project above where the low-income sample requirement is 12 units, for example, if through random sampling, a unit was not selected in buildings D and K, the agency would still be required to inspect buildings D and K to satisfy this provision.

Advance Notification Limited to Reasonable Notice:

An agency is prohibited from giving advanced notice that a low-income unit has been selected for inspection. The IRS Summary of Comments and Explanation of Provisions (84 FR 6076) opines that:

> *Thus, the validity would be destroyed if a project owner had an opportunity to selectively prepare the units in the sample for inspection. Consistent with preserving the validity of the inspection process, an Agency must select the low-income units to inspect in a manner that will not give advance notice that a particular low-income unit will or will not be inspected.*

To ensure the integrity of the inspection, the agency may notify the owner of the units selected only on the day of the inspection. However, there is a recognition that, prior to the actual day of the inspection, the owner will need to be notified that an inspection will occur.

As such, an agency can provide “reasonable” notice that an inspection will occur to facilitate collection of documents needed to prepare for tenant file review or, for a physical inspection, to notify tenants. Reasonability has been defined as 15 days — meaning the agency can only provide an owner with a 15-day notice of an inspection and is prohibited from disclosing the units selected until the day of the inspection.

The National Council of State Housing Finance Agencies (NCSHA) is working with the IRS and Treasury to extend some of these provisions. As of when this article was written, there is no relief or waivers in effect, and we are in the new normal.

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