State Housing Agency Perspective on Form 8823

by Susan M Westbrook, HCCP
Manager of Rental Assets
NC Housing Finance Agency
Raleigh, NC

Section 42(m)(1)(B)(iii) requires state housing credit agencies to set forth procedures for monitoring low-income housing tax credit (LIHTC) properties for noncompliance in the state's Qualified Allocation Plan (QAP). In addition, state housing credit agencies have a responsibility to report noncompliance to the Internal Revenue Service (IRS). States use Form 8823 to notify the IRS of noncompliance with Section 42 of the Internal Revenue Code, as well as building dispositions. It is important for owners to review the monitoring requirements in the QAP that the property was funded under, in addition to current federal regulations, to understand how to maintain compliance.

State agencies are required to report noncompliance found during monitoring to the IRS regardless of whether the noncompliance is corrected or not. Some owners are under the mistaken impression that noncompliance will only be reported if left uncorrected and are often surprised when corrected noncompliance is reported. If the noncompliance is corrected timely and within the correction period allowed by the state agency, there are unlikely to be negative consequences, such as recapture. Whereas, uncorrected noncompliance as of the close of the taxable year during the compliance period will likely result in a loss of tax credits, and possibly recapture of credits. Any potential recapture is determined by the IRS, not the state agency.

The IRS determines the penalties of noncompliance for the taxpayer, not the state. Because the credit stream is accelerated, recapture of the credits claimed may be necessary, in addition to forfeiting future credits, depending on the situation. Further, if the credit stream is interrupted, the investors may impose their own penalties due to the loss of credits.

There is a specific time frame for state housing credit agencies to report noncompliance. First, a correction period for the noncompliance must be provided to the property owner. The state is not to report noncompliance prior to the end of the correction period. The initial correction period is not to exceed 90 days from the date of the notification to the owner, but the state may set a shorter correction period. The most common is a 30-day correction period. The state may provide extensions to the corrections period if there is good cause; however, extensions are not

to exceed six months. The IRS requires states to file Form 8823 within 45 days of the end of the correction period, including any extensions.

The 8823 is the best enforcement mechanism that state agencies have available to command compliance from affordable housing partners. However, the 8823s should be administered fairly and in accordance with regulations. Allowing adequate time to correct the noncompliance issues, including extensions where warranted, sends a clear message that the state recognizes the value that the property owner adds as a partner in accomplishing their affordable housing mission, while also communicating that the regulations must be followed. A heavy-handed approach (issuing 8823s for state issues or issues that are not clear violations, or without allowing adequate time for corrections) creates an adversarial relationship. Issuing 8823s late shows a lack of respect for partners. While owners should adjust the credits claimed when they are aware of noncompliance, some owners wait to see if an 8823 will be issued before making any adjustments. Receiving the 8823 late can result in unpleasant consequences from investors who have claimed credits thinking no noncompliance existed. Not issuing 8823s at all results in mass noncompliance and unsafe housing because owners do not feel compelled to maintain compliance when there are no negative consequences for noncompliance.

The IRS relies on the state housing credit agencies to monitor for compliance. When noncompliance is discovered, the IRS expects the state agency to determine when and how corrections are made. While the IRS understands the regulations provided to states for enforcement, the nuances of compliance are left to the states to decide. For example, a third-party employment verification is unacceptable if some of the questions are left unanswered. Some states take a literal approach and the file is out of compliance until the missing information is provided. Other states take a 'big picture' approach. If the household is clearly income-eligible despite the missing information, the state may allow the file to be considered in compliance, either by obtaining the missing information, or despite the missing information. The IRS allows states to make the determination of whether the issue is corrected, whether to clear the finding, or whether the issue is uncorrected according to the response provided by the owner. Therefore, it is important for owners to maintain a good working relationship with the state agency. The IRS does not typically act as referee between the state and the owner. That said, the owner may seek a Private Letter Ruling (PLR) from the IRS to resolve a noncompliance situation. The PLR will come at a significant cost, and it can only be used in that one specific situation. If the situation occurs again, another PRL must be obtained.

While the 8823 is the tool of choice to help enforce compliance, state housing credit agencies do have other enforcement tools at their disposal. States may preclude the developer from receiving new allocations if there is uncorrected noncompliance in existing LIHTC properties. Because a 30-year extended use agreement is required, the state may sue for specific performance under this agreement. Property management companies are crucial to compliance, so some states have developed specific requirements for management companies to be approved to manage LIHTC properties in that state. While the developer may not be actively developing, the property management company needs to maintain a reputation of compliance in order to remain in business and obtain new contracts to manage affordable housing.

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