Back to Basics VI: Acquisition/Rehab

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

All tax credit properties are fairly complex: machines with many moving parts which must run smoothly. Existing buildings that are acquired and rehabbed with tax credits also involve communicating with the existing population, construction around them and unit transfers. From a compliance standpoint, there are also 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, compared to acq/rehab properties. ***Understanding the difference helps housing professionals avoid the confusion that sometimes can accompany acq/rehab compliance.***
In this article, several of these differences will be highlighted.

Two credit streams
The value of tax credits has, as a starting point, depreciable costs spent on a housing building. The accounting term for these costs is the *eligible basis* for a building. *New construction* costs are a common basis for tax credits. In addition, 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. Because the costs that go into the eligible basis for acquisition of an existing building are different from the costs for rehab of the building, each basis establishes a separate credit stream. Since each must be accounted for separately, each building subject to acq/rehab will have two allocation Form 8609s.

Applicable credit percentages also may 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.

Placed in service and start of credits
A sometimes confusing and crucial difference between acq/rehab projects and new construction 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 is issued. This date becomes important as a starting point. Leases and resident occupancy should not predate the placed-in-service date for a new construction building. Also, tax credits cannot be claimed on a building before 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. Thus, 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). That test 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 is placed in service. Note that this is not the rehab placed-in-service *date*, but rather the *year*.

Thus, credits may start at the acquisition date or the start of the year that the rehab is placed in service. 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 at the start of 2019.

With new construction, once a building is placed in service, credit may be claimed either 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 the date of acquisition. If a building was acquired in 2018 but the rehab was placed in service in 2019, credits may be claimed in 2019 or may be deferred to 2020. Thus, 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.

Qualifying households

While the claiming of credits is most sensitive to the year that the rehab is placed in service, qualifying households for tax credits begins 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 the paperwork should predate 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 acquisition. They allow that any certification done 120 days after (or before) acquisition may have an effective date as of the acquisition placed in service date. Therefore, effective dates may predate the date the paperwork is completed and signed by up to 120 days and still be compliant. Certifications 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 up over the limits by the start of the first year credits are claimed. Since acquisition may predate the start of credits by two or more years (as discussed above), the initial certifications 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.

Construction while dealing with the existing population provides a great deal of additional complexity than that 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.

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