



DATE: September 27, 2007
TO: Owners and Managers of Tax Credit Communities monitored by VHDA
FROM: Brenda D. Hawkins, Program Compliance Manager *BDA*
SUBJECT: New Compliance Guidance, Clarifications and Updates for the Tax Credit Program

On January 15, 2007, the IRS published on its website the long awaited Guide for Completing Form 8823. The guide is also posted on our website at www.vhda.com under Program Compliance/Tax Credit Program. We strongly encourage owners and managers review the contents of this guide to gain knowledge and understanding of reportable noncompliance issues. ***VHDA will follow the guidance provided in the new 8823 Guide for identifying and reporting noncompliance.***

Question: When is the Guide effective?

Answer: January 2007

VHDA delayed implementation and notification of the 8823 Guide in order to obtain clarification on issues that were unclear as well as identify changes that will affect VHDA and owners.

On the cover of the Guide, the IRS issued a disclaimer that owners and managers should be aware of. The disclaimer reads as follows:

The scope of this guide is limited to guidelines for preparing Form 8823 for submission to the IRS. Taxpayers are responsible for evaluating the tax consequences of noncompliance with IRC Section 42. Under no circumstances should the contents of this guide be used or cited as authority for setting or sustaining a technical position.

The purpose of this memo is to share with you changes that will affect owners as well as provide clarification and guidance on how VHDA will proceed in implementing the 8823 Guide. We are happy to inform you that for the most part, you will not see any major changes to what you were previously instructed to do. The Program Compliance Department is committed to providing consistent guidance and quality customer service to you.

The following pages identify changes affecting owners/managers of LIHTC communities. They also provide guidance on how to implement these changes. We strongly encourage owners and managers to maintain a notebook to retain this information for future reference.

If you have questions after reviewing this new guidance, please feel free to call or email your assigned Program Compliance Officer.

Notification of File Review

Date of audit notification letter starts the annual review



The date of the audit notification letter from VHDA now triggers the beginning date of the annual file review. Any noncompliance found by the State Agency on or after that date is reportable to the IRS. Any noncompliance found and corrected by the owner **prior** to the date of the notification letter is not reportable to the IRS.

This is good news, the IRS expects all owners to exhibit due diligence in making sure they comply with the requirements of the program. Owners should have measures in place to have ongoing reviews of the tenant files to ensure accuracy and completeness of tenant certifications and documents.

On page 3-4 of the 8823 Guide, the IRS has provided some guidance on the types of due diligence owners should undertake to maintain ongoing compliance.

NOTE: Beginning January 2005, VHDA adopted the policy to conduct desk audits on properties with 100 units or less. The desk review requires owners/management agents to submit copies of specific property and tenant data to the assigned compliance officer by an established due date. ***Please note that an owner's failure to supply the state agency with requested information for an audit is a reportable noncompliance issue.***

Verifications

Verification Timeline



For move-ins, initial and annual re-certifications, tenant verifications obtained to determine income and occupancy eligibility must be within 120 days prior to the effective date of the action.

NOTE: For properties with Tax Credits, the move-in Tenant Income Certification (TIC) must not be signed in excess of five (5) days prior to the move-in date.



Recertification

Now that verifications must be within 120 days prior to the effective date of a certification, tenants may sign the completed TIC any date within 120 days prior to the recertification effective date.

Example: Recertification is due 3/12/07. Management was able to obtain verifications and complete the recertification on January 15, 2007. Tenant(s) may sign the certification on January 15, 2007.

Note: Recertifications must be signed on or before the anniversary date of the household's original move-in date. An annual recertification signed after the effective date is considered late and will be reported to the IRS as being out of compliance. Under no circumstances should management have tenants sign a blank Tenant Income Certification or back-date the TIC.



Previously, VHDA allowed owners to have tenants sign the certification anytime during the recertification month. This practice should be discontinued effective immediately.



Verifications are valid for 120 days from the date of receipt by the owner.

Owners **must** date stamp all incoming tenant verifications with actual date received.

Please note VHDA's policy: The date the third party signed the verification will be used to determine if the verification is within the 120 day time frame for any verification without a received stamped date. The same will be applicable for any verification with a received stamped date in excess of 10 days after the third party's signature date.

Effective Date of Tenant Income Certification

TIC Effective Date



The effective date of the tenant's income certification is the date the tenant actually moves into the unit.

The annual income recertification is effective on the anniversary of the move-in effective date.

Example: Tenant moved in 8/12/2006, recertification is due and effective 8/12/2007.

Note: This is a change, as many owners/management agents have used the tenant sign date, and the lease date as the effective date of the tenant certification.

Effective immediately upon receipt of this notice, owners/management agents must be consistent in determining effective dates based on guidance given above and as stated in the 8823 Guide.

Properties with Section 8 and Tax Credits

Properties with Tax Credits and project-based Section 8 should continue to follow the recertification schedule for the Section 8 Program. The IRS will not penalize owners for completing recertifications early. Tenants under the Section 8 program must recertify annually by the first of the move-in month.

Example: John Travolta moves into a Section 8 property on July 12, 2006. His annual recertification is due July 1, 2007. Because this is a combo property, the July 1, 2007 recertification will satisfy both program requirements. However, if management is late recertifying a household, it is an IRS reportable noncompliance issue for Tax Credit purposes.

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Effective Date of Tenant Income Certification, Continued

RD Properties with Tax Credits



Rural Development properties with Tax Credits must now recertify households annually based on the anniversary date of the move in. The RD program allows for recertifications anytime there is a change in the household. When this occurs, the effective date of the annual recertification changes also. As of January 2007, the IRS issued guidance that the RD Program policy of changing the annual recertification dates is not acceptable for the Tax Credit Program.

VHDA realizes this change will result in an owner re-certifying households sometimes more than once in a given year to satisfy the requirements of both programs. Therefore, VHDA will accept an annual recertification completed for the RD program provided the verifications are within 120 days of the effective date of the Tax Credit annual recertification.

Example: Tenant moved into the property 10/12/2006. For Tax Credit purposes, the annual recertification date for this household is 10/12/07. The household encounters a change in income in July 2007 and for RD purposes, management completes an annual recertification effective July 2007. Due to this change, management will be verifying the income of the household in July or August. Those verifications will be within 120 days of the effective date of the Tax Credit recertification date; therefore, that one recertification will cover both programs. Management will still need to enter the annual recertification into WCMS with an effective date of 10/12/2007 for Tax Credit purposes.

File Documentation

**Proper File
Documentation**

Owners and management agents are required to maintain documentation in each tenant's file to support eligibility and qualifications for occupying a low-income tax credit unit.

VHDA strongly encourages owners and management agents to attach calculator tapes to income verifications to show how income was calculated.

**Tenant
Notification of
Annual
Recertification**

Management must maintain documentation in the tenant's file to show proof that notification of the annual recertification process was initiated timely. All follow up notices must also be retained in the tenant's file. Currently, owners can start the annual recertification process 120 days prior to the effective date.

Properties with a recertification waiver must also maintain documentation in the tenant file to show that the tenant received proper notification to disclose their income for the annual recertification.

NOTE:

An owner's failure to annually recertify households timely is an IRS reportable noncompliance issue. The IRS may also revoke waivers for late recertifications. Remember, form 8823 must be completed regardless if the noncompliance is corrected.

Additional Household Members



Adding new household members

When adding new member(s) to an existing household, management must require the applicant(s) to complete an application. The income of the new member(s) must be verified. Management must process an interim certification in WCMS and make the interim effective the date the new member(s) actually moves in.

Management must add the new member(s) to the lease.

The unit will continue to be counted as low-income; however, the **Available Unit Rule** applies if the household's total income is now over 140% of the current income.

Caution: If all original household members vacate a unit, the remaining members must be certified as a new household and be income qualified.

Example: Tom and Jerry moved in as a qualified household on 5/15/06. Sylvester moved in with the couple on October 1, 2006. On November 30, 2006, Tom and Jerry, the original household members, move out. Now that the household does not have original members, management must certify Sylvester as a new qualified household retroactive to October 1, 2006.

The guide indicates that state agencies are to look for patterns of tenants manipulating the income limit by adding household members soon after move-in.

Failure to update existing Tenant Income Certification when a household composition changes is an IRS reportable noncompliance issue.

True and Correct Statement

Use of True and Correct Statement



Effective immediately, True and Correct Statements will be acceptable **only** in the following instances:

- If a Move-in Certification requires further clarification based on information disclosed on the rental application, student status or income verification.
- If a recertification was processed timely; however, internal or state agency review determines documentation needs further clarification.

NOTE: True and Correct Statements will not correct a late or missed recertification.

Dating True and Correct Statements

When a true and correct statement is needed, the tenant must date the document using the current date but indicate that the information being corrected is true and correct as of the effective date of the certification.

Example: When processing a 3/12/07 annual recertification, management failed to follow-up on a salary increase noted on the employment verification. Management was instructed to verify and update the annual income for the household. The certification was corrected with the updated information. The tenant should indicate the information was “true and correct as of 3/12/07” but sign and date with today’s date.

Also, the person providing the 3rd party verification must certify that the information is “true and correct as of 3/12/07” and sign and date with the current date.

Child Support Verification

Alimony or Child Support

VHDA will follow the guidance as stated in the 8823 Guide regarding child support verification.

Alimony or child support that is court ordered or supported by a written agreement should be included in income unless the recipient certifies that the funds are not received and reasonable efforts have been made to collect the amount due, including filing with courts or agencies responsible for enforcing payments.

Verification – When no documentation of child support, or alimony stipulated in the divorce decree or separation is available, the owner *may* require the family to sign a certification. The certification must be notarized. Documentation of the collection efforts made may be requested.

NOTE: Under no circumstances should on-site management staff notarize any documents pertaining to a tenant's certification.

A signed, sworn self-certification by a tenant is sufficient documentation to show that a tenant is not receiving child support payments and is consistent with the documentation requirements as outlined in the HUD Occupancy Handbook 4350.3. In addition to specifying that a tenant is not receiving any child support payments, an annual signed sworn self-certification should indicate whether the tenant will be seeking or expects to receive child support payments within the next 12 months.

If a tenant possesses a child support agreement, but is not presently receiving any child support payments, the tenant should include an explanation of this and all supporting documentation; i.e., a divorce decree or court documents. Also, the self-certification should indicate that the tenant would notify the owner of any changes in the status of child support.

Owners/management agents must retain copies of supporting documentation of child support or lack of child support in the tenant(s) file.

Fees

Fees as a Condition of Occupancy

Any charges to low-income tenant for services that are not optional generally must be included in gross rent. A service is optional when it is not a condition of occupancy and there is a reasonable alternative.

The costs of services that are required as a condition of occupancy must be included in gross rent even if federal or state law required that the services be offered to tenants by building owners.

- **Refundable fees** associated with renting an LIHTC unit are **not included** in the **rent** computation. Example: Security deposits and fees paid if a lease is prematurely terminated are one-time payments that are not considered in the rent calculation.
- **Required costs or fees**, which are not refundable, **are included** in the **rent** computation. Examples: Month-to-month tenancy and renter's insurance.

Reference: Treas. Reg. 1.42-11. Please also review Chapter 11 of the 8823 Guide.

Renter's Insurance - Change in Previous Instructions from VHDA



Previously, VHDA was more liberal in its interpretation of the regulation and issued a policy stating that if management requires renter's insurance on properties and the resident is responsible for setting up their own policy and paying the premium directly to the insurance company of their choice, the insurance amount(s) do not need to be included in the monthly amount toward maximum rent as long as the insurance benefits the resident and not the owner.

NOTE: Since the IRS has specifically clarified that any charges that are not refundable and are a condition of occupancy must be included in rent, VHDA is rescinding its policy on renter's insurance to comply with the guidelines established by the IRS.

Full-Time Students

Defining Student for Tax Credit Purposes



As stated in the 8823 Guide – IRC Section 151 (c)(4) defines, in part, a “student” as an individual who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins, is a full-time student at an educational organization described in IRC Section 170 (b)(1)(A)(ii). Treas. Reg. Section 1.151-3(b) further provides that the five calendar months need not be consecutive.

A household in a Tax Credit property cannot be comprised of all full time students unless

- A student is receiving assistance under Title IV of the Social Security Act (TANF)
- A Student is enrolled in a job training program receiving assistance under the Job Training Partnership Act or similar program
- Single parent(s) with children all of whom are students and such parents and children are not dependents of another individual
- Married and file a joint return (not necessarily with each other)

Effective immediately, owners must comply with the student definition as specified in Chapter 17 of the 8823 Guide.

Caution: Owners of properties with both Section 8 and Tax Credits must comply with the student rules for both programs.



The VHDA Tax Credit Compliance Monitoring Manual (*last revised Jan'02*) indicates that an individual is considered a student if attending school full time 5 months of the recertification year. VHDA will be updating the manual to comply with the code.

Utility Allowances

Appropriate Utility Allowance

Owners of Tax Credit properties in Virginia currently have the options of using utility allowances

1. Established by the local PHA, or
2. Obtaining estimates from a local utility company

Tax Credit properties with a project-based Section 8 contract must use the utility allowance approved by HUD.

Tax Credit properties with project-based Section 8 Vouchers (HCV) must use the utility allowance established by the local PHA.

Tax Credit properties that accept Housing Choice Vouchers must use the utility allowance established by the local PHA for units occupied by the HUD- assisted tenants. For the remainder of the units, the owner may obtain estimates from a local utility company or use the allowance established by the PHA for the entire property.

Tax Credit properties with no HUD assisted occupants may obtain estimates from a local utility company or use the allowance established by the local PHA.

NOTE: Once the utility allowance option is selected, an owner is only allowed to switch options once during the initial compliance period.

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Utility Allowances, Continued

IRS Proposed Regulation on Utility Allowances



On June 18, 2007, the Internal Revenue Service (IRS) issued proposed regulations that would change the way rents are adjusted on LIHTC properties when residents pay for their own utilities.

The proposed regulation would allow state LIHTC allocating agencies (typically state housing finance agencies) to provide utility estimates. It would also allow property owners to submit data from their utility company or use the data from a new HUD utility modeling program.

The proposed rule also allows for a grace period before rents can be adjusted during the initial stabilization period. It would require rents to remain unadjusted for a period of one-year, or until the property has achieved 90 percent occupancy for 90 consecutive days, whichever comes first. This provision will allow properties to stabilize before rents are lowered to account for increased utility charges.

Please Note: These are **proposed** regulations and should not be implemented. Owners may go to the www.irs.gov web site and search for Section 42 Utility Allowance Regulations Update. A copy of the proposed Utility Allowance Change can be found at the following website: <http://www.nmhc.org/Content/ServeFile.cfm?FileID=5883>

Recertification Waiver

Recert Waiver Guidelines



The VHDA guidelines for requesting a recertification waiver are now posted on our website at www.vhda.com under Program Compliance/Low Income Tax Credit Compliance/Program Compliance Options.

Owners are encouraged to thoroughly review and follow before requesting a waiver.

How does new 8823 Guide affect properties with a waiver?

The IRS will grant a waiver to an owner that has demonstrated due diligence in complying with all aspects of Section 42 on an ongoing basis. Owners/management agents must understand that receiving a waiver not to re-verify the income of existing households annually for recertifications is a privilege. It is a waiver granted because of the owner's due diligence and quality of work in complying with the requirements of the Tax Credit Program.

According to the 8823 guide, a waiver can be revoked when an owner ceases to comply with Section 42 on an ongoing basis. Owners with waivers should be aware that if an unqualified household is allowed to move in, all existing households will need to be recertified and income verified (third party) to determine if the next available unit rule was violated. Owners will have to re-certify and re-verify the income of those existing households retroactive to the date that the unqualified household moved in.

If the next available unit rule is violated, this action alone constitutes a revocation of the recertification waiver. Owners should also be aware that late recertifications will too result in the revocation of the waiver.

Recertification Waiver Documents



Properties with the recertification waiver should use the "Tenant Income Worksheet" form located on our website as a tool to gather household composition, student status and income information. Owners must then enter that information into WCMS and print the TIC. The WCMS generated TIC should be signed and dated by the resident(s) and management and retained in the household's file.

Physical Inspections

Physical Inspection of Tax Credit Unit

State agencies must inspect Low-Income Tax Credit properties to ensure that buildings and units are suitable for occupancy. Under Treasury Regulation Section 1.42-5 (C)(2)(ii)(B), onsite inspections must be conducted at least once every three years. The standard for these on-site inspections requires state agencies to determine whether the buildings and units are suitable for occupancy based on local health, safety and building codes or whether the buildings and units satisfy the Uniform Physical Condition Standards (UPCS) established by HUD.



NOTE: While the requirement to conduct physical inspections is not new to owners and management agents, special attention **must** be given to the ongoing condition of the property and units. The IRS is requiring state agencies to report all levels of physical deficiencies on Form 8823. VHDA strongly encourages owners and management agents to review chapter 6 of the 8823 Guide regarding violations of the UPCS standards. According to this new guidance, smoke detectors that are inoperable **or** without batteries are reportable IRS noncompliance issues.
