CHAPTER 3 – RULES, REVENUE PROCEDURES, AND OTHER GUIDANCE

Section 42 of the Internal Revenue Code ("Code") contains LIHTC Program requirements. The Code incorporates Program changes and revisions made by the Budget Reconciliation Acts of 1989 and 1990. Additionally, the IRS publishes, on an ongoing basis, revenue notices, rulings, and regulations that clarify and/or expand on the law. (See Exhibits and Supplemental Information Sections)

The following discussion highlights *some* of the Code provisions directly affecting project compliance. **It is not a complete listing of compliance regulations.**

Applicable Fraction

The "applicable fraction" is the lesser of the following: the actual percentage of low income units in the project or the actual percentage of residential square feet occupied by low income tenants which the Owner has reserved for low income tenants. The applicable fraction must be met throughout the compliance period. The applicable fraction is memorialized within the Declaration of Land Use Restrictive Covenants.

Manager Units

For buildings placed in service after September 9, 1992, a unit occupied by a full-time manager, who is not income-qualified, should be treated as having the same status as a "common area" if the project requires the manager to live on-site. To qualify as a common area the unit must support the benefit of all rental units in the project and the staff member occupying it must be full-time to the project. IRS regulations define common areas, in part, as areas "reasonably required" by the project. OHCS may determine, based on the individual project, and all facts and circumstances, that a manager's unit is not reasonably required.

Per IRS Revenue Ruling 92-61, "the adjusted basis of the manager's unit is included in the eligible basis of the qualified low-income building under IRC §42(d)(1), but excluded from the applicable fraction under IRC §42(c)(1)(B) for purposes of determining the building's qualified basis."

Example:
If a building contains 100 units with 99 occupied by low-income tenants and 1 occupied by a resident manager, the applicable fraction would be 99/99 or 100% (not 99/100 or 99%). The manager's unit is then treated as a "common area".

OHCS will not monitor the use of approved common area manager units, except to confirm that the unit is occupied by staff whose activities and functions fulfill the project's management needs and that rent is not being charged to the staff person(s) occupying the unit. **OHCS reserves the right to approve or disapprove the use of any unit for staff members**.

OHCS currently designates in new Reservation and Declaration documents any units intended for managers *that will not be part of the low-income set-aside*. Older projects that do not have this documentation must obtain approval from OHCS for this use.

Minimum LIHTC Set-Aside Election

At the time of application for the tax credit, the Owner of the project must choose one of two minimum set-aside requirements. This election, once memorialized within the Declaration of Land Use Restrictive Covenants and once elected on the IRS Form 8609 (see **Exhibit E.5**), is irrevocable. If the Managing Agent is unaware of which set-aside requirement must be met, he/she should contact the Owner.

The set-aside is the minimum number of units that must be rent restricted and reserved for low-income tenants in order for a building to be considered a qualified low income building. Pursuant to the Code, the set-aside options are:

- At least 20% of the available rental units must be rent restricted and occupied by households whose income is 50% or less of the area median gross income as adjusted for family size; or

- At least 40% of the available rental units must be rent restricted and occupied by households whose income is 60% or less of the area median gross income as adjusted for family size.

These elections are the minimum required by the Code. **Actual compliance monitoring will be based upon the more restrictive representations made by the Owner in the application for credits**. Projects will be subject to comply with the more restrictive requirements.

Minimum Set-Aside Deadlines

For projects receiving credits in 1991 and later, the minimum set-aside must be met by December 31 of the year the project is placed in service, if credits are to be claimed for that year. If the start of the credit period is deferred until the second year, the minimum set-aside must be met by December 31 of the second year. Once the minimum set-aside is met, it must be maintained for the entire compliance period.

Maximum Income Limits

Maximum income limits for qualifying tenants depend on the minimum low-income set-aside election the Owner has chosen. Qualifying tenants in projects operating under the "20/50" election may not have incomes exceeding 50% of area median income adjusted for family size. Tenants who qualify to live in projects that operate under the "40/60" election may not have incomes exceeding 60% of area median income adjusted for family size. **Special elections made by the Owner in the application for tax credits will be required to be maintained**.

MTSP Income Limits

The U.S. Department of Housing and Urban Development (HUD) publishes median income information for each Oregon county or metropolitan statistical area (MSA) of the state on an annual basis for the Multifamily Tax Subsidy Program (MTSP) (see **2009 MTSP Limit Letter to Owner-Agent**).

This publication includes amounts for family sizes ranging from one to eight household members, under two sets of limits: (1) the **HERA Special Income Limits** and (2) the **Actual Income Limits**. All tax credit and tax exempt bond projects are eligible to use the Actual Income Limits posted each year.

⇨ *HERA Special Income Limits*

The Housing and Economic Recovery Act of 2008 (or HERA) defines projects eligible to use the HERA Specials as those that were in service in 2007 or 2008 and located in a HUD Hold Harmless Impacted area. OHCS has added further interpretation of the HERA legislation that defines "in service" to mean any project that was placed in service on or prior to December 31, 2008.

Projects placed in service on or after January 1, 2009 will defer to the current year's Actual Income limits published, though once placed in service will be held harmless to any future decline in the Actual Income Limits.

National Non- Metro Limits

In addition to the HUD Hold-Harmless Income limits, HERA provides certain LIHTC projects with rural or non-metro designations the option to use the **National Non-Metro Median Income Limit** versus the areas Actual Income Limit should it be higher. The USDA determines whether or not your project is located in an area designated as rural (see **Rural Housing Eligibility**). **This rule went into effect on 07/31/08, is not retroactive, and only applies to rural or non-metro LIHTC properties with 9% credit allocations**. Housing Credit projects with tax-exempt bond financing or HOME funding are not eligible to use the National Non-Metro Income Limits.

If your project was placed in service on or prior to 12/31/2008, is in a HUD Hold Harmless Impacted area, and has an address designated as rural (by the USDA), the owner may use the highest of the three income limits available.

Upon receipt of the information from HUD, OHCS calculates additional income levels with corresponding rent limits, and makes them available to Owners and Agent for projects subject to utility allowance adjustments and other restricting agreements made in order to justify Credit need.

Note: **It is the Owner's responsibility to obtain the new limits each year.** Owners are not permitted to anticipate increases in income and rent limits. Income limits become effective when published by HUD, and will remain so until HUD officially replaces those with new limits.

The Supplemental Information section of the OHCS website provides the most current Income and Rent limits available (see **S.7 Income & Rent Limits**), and is updated annually within a few days of HUD's posting.

When determining if a tenant's income is at or below the applicable limit the income from each adult household member 18 years of age or older that will be living in the unit must be included (refer to Chapter 5, "Qualifying Tenants", for more detail).

If the household income of a qualifying unit increases above 140% of the applicable income limit and the household initially met the qualifying income requirements, the unit may continue to be counted as a qualifying unit as long as the unit continues to be rent restricted as set forth in **Maximum Rent Limits** below and the next available unit of comparable or smaller size is rented to a qualified low-income tenant(s).

Maximum Rent Limits

For projects receiving a Credit allocation after December 31, 1989, gross rent, **including utilities**, paid by tenants in qualifying units may not exceed 30% of maximum qualifying income based on an assumed 1.5 person per bedroom calculation.

Note: Efficiency (studio) units are based on one person occupancy. Gross rent must include an allowance for any utilities paid by the tenant. Utility allowances must be determined according to Program requirements (see **Supplemental Information, S.2** and **Supplemental Information S.2a**). Please refer to Chapter 4, "Compliance Monitoring Procedures" (Utility Allowance Documentation), for more details.

Federal, State or Local Assistance

Gross rent does not include any payment under Section 8 of the United States Housing Act of 1937 or any comparable Federal rental assistance program with respect to such unit or occupants thereof. With the Tax Reform Act of 1986, Congress further clarified that any comparable state or local governmental rental assistance would not be included in gross rent (IRC §42(g)(2)(B)(i)).

⇨ *Housing Choice / Project Based Vouchers*

Per guidance by HUD (in 2005 and 2007) and the IRS (in 2007), tax credit residents with Housing Choice or Project-Based vouchers can be charged gross rents that exceed the LIHTC maximum allowable rents as long as the owner receives a Section 8 assistance payment on behalf of the resident. If at some point the resident is no longer eligible to receive the voucher, the owner of the LIHTC property must lower the tenant's portion of rent to at or below the maximum applicable program rent allowed.

Supportive Services

All fees for supportive services the tenant pays to the Owner must be included in the gross rent. These services are intended to help residents become more independent and to post-pone the need to be placed in a nursing home or other intermediate mental or physical health care facility. Providing transportation or housekeeping, or sponsoring social events are examples of supportive services.

Rent Overcharged

The Housing Credit Program mandates that **gross rents remain restricted on an annual basis** (under IRC §42(g)(2)(A)), **as well as on a monthly basis** (under IRC §42(g)(2)(B)). If it is discovered that an owner has overcharged rent to a LIHTC resident at any point during a calendar year, the following results will occur:

1. The owner will be required to refund the excess rent amount to the tenant for all months affected, and
2. **The IRS will recapture tax credits on the affected unit for the remainder of the calendar year**, beginning with the first month the rent was overcharged.

In some cases, rents become overcharged when owners assess fees not permitted under Section 42, such as fees for the use of resident facilities (i.e. swimming pools, parking areas, recreational facilities) that were included in the project's eligible basis. Other cases involve owners charging fees to residents as a condition of their occupancy, where the fees are in addition to gross rents (i.e. mandatory renters insurance, fees for month-to-month tenancy, one-time washer/dryer hookup fee).

Example 1: Maximum LIHTC Rent = **$550**

Tenant Rent =	$525
Late Fee Assessed =	$75
Total Paid by Tenant =	**$600**

Rent is due on or before the 5th day of each month. A tenant doesn't pay until the 8th day. The owner has the right to assess a late fee because of the lease violation committed by the tenant. Gross rent **has not** been overcharged.

Example 2: Maximum LIHTC Rent = **$550**

Tenant moves in on March 1, 2009 and receives a rent concession. Owner wants to recoup the concession during the remaining months.

Tenant Rent (March) = $0
Tenant Rent (**April – December**) = **$575**

Gross rent was overcharged from April through December. Not only will the owner have to refund the amount overcharged for each month, he/she will lose credits on the unit from April through December. If the unit is rent-restricted as of January 1, 2010, and the tenant has received a refund for the overcharged rent, the unit can be placed back into compliance.

The earliest date an overcharged LIHTC unit can regain compliance is the first day (January 1st) of the following tax year, provided the unit is rent-restricted under the applicable program rent requirements.

Rules Governing Low-Income Eligibility of Units

If the income of household in a low-income unit increases above the maximum allowable income limit, the unit will still qualify as a low-income unit as long as the household **initially qualified and the unit remains rent-restricted** as set forth in **Maximum Rent Limits** above.

Available Unit Rule (or Next Available Unit Rule)

If the household income in a low-income unit increases above 140% of the current maximum allowable income limit, the **next available unit** of comparable or smaller size in the building must be rented to a household having a **qualifying income in order to remain as a qualified set-aside unit** (see **Supplemental Information S.4**).

This rule should have no impact on 100% LIHTC projects since every unit must be rented to eligible LIHTC households. In mixed-income projects, market rate units may have to be rented to LIHTC qualified households in order to remain compliant because the unit exceeding 140% can no longer be counted in the LIHTC set-aside.

Vacant Unit Rule

Owners are required to make newly vacated units suitable for occupancy in a **reasonable amount of time** (defined by OHCS to be **30 days or less**).

The IRS states that, "All vacant LIHC units that are not suitable for occupancy are out of compliance. The out of compliance date is determined for each unit based on the date that particular unit was vacated." The units will not be considered back in compliance until they have been occupied by income-eligible households.

Example:
OHCS conducts a physical inspection of a property and discovers that 20 units are currently vacant and have been for **more than 30 days**. During the inspection, only 5 of the units were found to be in "rent-ready" condition. The owner tries to reason with the auditor by saying his maintenance person quit and he did not have enough staff to prepare the units. The 15 vacant units that have not been prepared for occupancy are out of compliance.

Treasury Regulation §1.42-5(c)(1)(ix) requires state HFAs to mandate that owners certify annually that **reasonable attempts** are made to rent a vacant tax credit unit, or the next available unit of comparable or smaller size, to a household who is income-qualified before any units of comparable or smaller size in the project are rented to a non-qualifying household (i.e. in a mixed-use building).

Note: If the project is a 100% set-aside LIHTC project, **non-qualifying** tenants are **never allowed to move in** without jeopardizing the Credit.

Student Eligibility

The LIHTC program prohibits the rental of set-aside units to entirely full-time student households not qualifying for a specific exception. Per the IRC, Section 42, student status must be addressed annually for each household applying for (or currently resides in) a Housing Credit unit during the initial compliance period. Effective January 1, 2009, **owners/managing agents are required to have each household complete an Annual Certification of Student Status (Required Form OHCS.5)**.

Form OHCS.5 was revised on 03-10-10

As suggested by the IRS, **a unit will be out of compliance "if the owner fails to verify the household's student status at the time of move in, or the annual student status verification was performed late *and after notification of a state agency review*."**

⇨ *Student Defined*

Internal Revenue Code Section 151(c)(4) defines the term "student" as "an individual who during each of five calendar months during the calendar year is a full-time student" at an "educational institution" described in Code Section 170(b)(1)(A)(ii). Treas. Reg. Section 1.151-3(b) provides that a full-time student is one who is enrolled for **some part of five**

calendar months for the number of hours or courses, which is considered to be a full-time attendance. The five calendar months need not be consecutive.

Example:
An applicant moves in by herself on June 1, 2009. She reported being a full-time student from January 4th through March 19th of the same year. Shortly after moving in she became a full-time student again on September 6th and continued on through December.

The unit would be out of compliance beginning October 1, 2009 because this represents the first day of the fifth month in which she was considered to be a full-time student during a calendar year (2009).

The unit will not be compliant until the current tenant falls under one of the student exemptions (as listed below) or the household is not occupied entirely by full-time students.

⇨ *Determination of "Student Status"*

Per IRS Guidance, "**The determination of student status as full or part-time** should be based on the criteria used by the educational institution the student is attending."

Full-time attendance at an educational institution may include some attendance at night in connection to a full-time course of study. In addition, individuals pursuing a full-time course of study through an institution providing on-farm training under the supervision of an accredited agent of such educational institution, of a state or political subdivision of the state, may also be deemed as full-time students.

Note: Individuals attending on-the-job training courses are not considered to be students.

⇨ *"Educational Institution"*

"Educational institutions" include colleges, universities, trade, technical and mechanical schools, as well as public and private elementary, junior and senior high schools.

⇨ *Exemptions of Student Status*

As a general rule, the household may not be occupied, **in its entirety,** by full-time students. Thus, if any one single individual in the household is not a full-time student, the application will still qualify under the student status requirements.

If all tenants are full-time students, the applicants may still be eligible to reside in a Housing Credit unit if one of the following exemptions, under IRC §42(i)(3)(D), apply:

- Students are married and entitled to file a joint federal income tax return. (A married couple who has not filed a joint tax return but is eligible to do so will still qualify, but will need to submit a copy of their marriage certificate); or
- The household consists of an **independent** single parent and his/her children, all of whom are not dependents of a third party **other than the absent parent**; or
- At least one household member receives welfare assistance under Title IV of the Social Security Act (AFDC/TANF); or
- At least one household member is enrolled in and receiving assistance under the Workforce Investment Act (WIA – formerly the Job Training Partnership Act) or other similar programs operating under Federal, State or local laws; or
- At least one household member **previously** received Foster Care Assistance under part B or E of Title IV of the Social Security Act (H.R. 3221, effective 07/30/08 forward).

⇨ *"Grandfather" Rights*

Note that student status is not subject to any "grandfather" clauses as are income limits. At no time during the lease, or any extension thereof, may the unit be occupied entirely by full-time students who are not otherwise exempt. If a household qualified at move-in but later became comprised entirely of full-time students (not meeting one of the exemptions), the household would no longer be considered qualified to occupy the unit.

Transfers
Form OHCS.9 was revised on 03-30-10

Owners and/or managing agents are required to complete a Unit Transfer Certification Form (**Required Form OHCS.9**) with each unit transfer processed. This form will assist in tracking the unit transfers within your project to ensure that compliance is maintained with respect to the project's set-asides and the Available Unit Rule (more specific to mixed-income properties).

⇨ *Transfer Within Same Building*

If a qualified household transfers from one unit to another within the same building, the two units would exchange (or "swap") status. If both units were tax credit eligible prior to the transfer, their status would remain the same.

A unit transfer taking place within the same building **does not require** income recertification of the household. The current household's file, which contains the tenant income certification (TIC) and lease for the original unit, will transfer with them. The two units swap status but do not need to be comparable in size. In addition, the rent on the newly occupied unit will remain rent-restricted even if the current household income (**based on the most recent TIC completed**) exceeds the current applicable income limitations.

Example (from the 8823 Guide):
An initially income-qualified household occupying a low-income unit in a mixed-use project was determined to have income in excess of 140% of the current AMGI at the time of the last annual income recertification. The household subsequently moved from Unit A, a 2-bedroom (now over-income) unit to Unit B, a vacant 3-bedroom low-income unit.

Even though the units are not comparably sized, Unit A is now a low-income unit and Unit B is an over-income unit.

⇨ *Transfer to a Different Building*

A transfer from one building to another building **within the same project** is allowed, provided the household's current income (based on the most recent TIC completed) **does not exceed 140%** of the current applicable income limit. The vacated unit will assume the status the newly occupied unit had just prior to the transfer. The newly occupied unit will remain rent-restricted and the household's tenant file will transfer with them.

Both buildings involved must be considered as part of a multiple building project, as elected by the owner on line 8b of the "Low-Income Housing Credit Allocation & Certification" (**E.5 - IRS Form 8609**). If the owner checked "Yes" on line 8b of both forms, he/she has opted to treat the buildings as part of a multiple building project.

If "No" is checked on line 8b of the 8609 forms, the owner is electing to treat each building as separate projects. As such, transfers between the two buildings cannot take place.

If an existing household requests to move from one building to another and both buildings are being treated as separate projects, the existing household **must initially qualify** under the Section 42 income limits currently in effect (within 120 days prior to the effective date of the move-in TIC). The owner will need to complete a new TIC, obtain third-party verification of household income and assets, and initiate a new lease for the new unit.

Households and Family Size

In order to determine the appropriate income limit for a specific household, the owner/managing agent must consider all individuals who will reside in the unit. There will be times when **absent family members will be included** as part of household composition for purposes of determining the applicable income limit. Such absent family members include:

- Children temporarily placed in a Foster Care home,
- Children present **at least 50% of the time**, as mandated by joint custody arrangements (if disputed, determine which parent claimed the children on his/her tax return),
- Children who are away at school but return to the household during school recesses,
- Unborn children (as self-certified by the pregnant mother),
- Children in the process of being adopted,
- Temporarily absent members still considered part of the family (i.e. due to out-of-state job assignment),
- Family members in rehabilitation facilities or hospitals for a limited time period (or longer), and
- Family members who are permanently confined to nursing homes or hospital. The family makes the decision as to whether or not to include the permanently confined family member as part of the household's composition.

Conversely, there will be other scenarios where an occupant of the unit will NOT be considered as part of the household for **purposes of determining the applicable income limit. Do NOT count the following individuals to determine the income limit based on family size**:

- <u>Live-in Caregivers</u>
  - Do **NOT** count their income.
  - Caregivers only reside in tax credit units to provide necessary supportive services to income-qualified tenants. Because the live-in caregiver is not included in the household's composition, the caregiver's income and assets would not be considered.
- <u>Guests</u>
  - Do **NOT** count their income.
  - Defined as visitors "temporarily staying in the unit with the consent of the tenant or another member of the household who has expressed or implied authority to consent on behalf of the tenant."

- Foster Children
  - Do **COUNT** unearned income and any income earned from assets.
  - Defined as being "in the legal guardianship or custody of a State, county, or private adoption or foster care agency, yet are cared for by foster parents in their own homes under some kind of foster care arrangement with the custodial agency.
- Foster Adults
  - Do **COUNT** earned and unearned income and any income earned from assets.
  - A foster adult is someone who cannot live alone due to a disability, and is typically not related to any of the tenant members.
- Foster Children/Adults
  - Do **NOT** count state foster payments made for the care of the foster child or adult

Note: Clarifications made regarding the treatment of earned and unearned income of foster children and foster adults were recently supplied by the IRS with guidance from the HUD Handbook 4350.3.

Adding a New Household Member

OHCS disallows the addition of new household members within the first six months of occupancy. This policy was established to help prevent the manipulation of the applicable LIHTC income limits. Owners should include language in the lease prohibiting the addition of new household members prior to the expiration of the initial six-month lease, **with exception to children born to or adopted by** a member of the original household.

After the initial six-month lease has been fulfilled, the addition of a new household member would require management obtaining third-party verification of the income and assets for the new individual. Upon receipt of the third-party documentation, management would add the new member's information to the existing household's most recent certification. The new member will then sign and date the certification, using the date the form was actually signed.

If the combination of the income and assets of the existing household and new member exceeds 140% of the income limit, the Available Unit Rule would apply (see **Supplemental Information S.4**). As long as the unit remains rent-restricted and the next placement is granted to an income-qualified household into a **unit of comparable size or smaller**, the building will remain in compliance.

No Original Qualifying Tenant Left in the Household

If all of the original qualifying household members are no longer residing in the unit, **the remaining members must be certified as a new LIHTC-qualified household.** Owners are highly encouraged to include language within the lease explaining this requirement.

The only time remaining members in a unit would not be required to certify as a new household would be if one of the following situations had previously occurred:

1. For a 100% LIHTC building:
   The owner/agent independently certified the remaining members at the time they were added to the unit , or

2. For a mixed-use building:
   a. The owner/agent independently certified the remaining members at the time they were added to the unit, or
   b. The owner/agent certified the newly created household at the time the additions to the unit were made

Evictions for Good Cause

IRC, Section 42(h)(6)(E)(ii) and Revenue Ruling 2004-82 Q & A prohibit “no cause” evictions during the entire term of affordability. Owners must comply with eviction laws established by the applicable state and local laws for which the property exists. In addition, an owner must be able to demonstrate that there was “good cause” for terminating a lease agreement.

Examples of situations that have resulted in good cause terminations include the failure to pay rent, lease violations, engaging in illegal activities on the property, and disturbing the peace of neighboring residents.

Tenant Fraud or Misrepresentation

If an owner discovers that a resident purposefully provided false income and/or household status information in order to qualify for a housing credit unit, the owner should report the fraudulent event to the “Whistleblower Office” of the IRS by completing Form 211, “Application for Award for Original Information” (see **IRS Form 211**).

Form 211 instructs an owner to include the name and social security number (if possible) of the tenant, furnish an explanation of how the tenant misrepresented his/her income, include the amount of income the tenant reported to earn versus the amount verified, and to provide the monetary difference between the restricted rent (the amount the tenant had been paying) and the current market rent for the affected unit.

When an owner discovers that a tenant has manipulated their income and/or household status in order to appear to qualify for housing under the Section 42 Program, **the fraud will not be reported as a noncompliant event as long as the owner**:

1. discovered (and addressed) the fraud **prior to receiving** notification of a state agency or IRS review of the project,
2. provides adequate proof to the state agency that the tenant provided false information,
3. performed due diligence at move-in or recertification to obtain the most accurate information possible from the tenant and applicable third party sources,
4. has implemented additional safeguards since the event in order to prevent the same situation from occurring again,
5. has legally terminated tenancy resulting with the resident vacating the unit (if possible), and
6. does not display a pattern of accepting fraudulent tenants.

If, however, tenant misrepresentation or fraud is **discovered during an audit conducted by the IRS or state agency,** which results in noncompliance with the Section 42 Program, **the noncompliance will be reported on Form 8823, regardless of the cause.**