

February 6, 2015

Paul F. Handleman, Esq.
Chief, Branch 5, CC: PSI
IRS Office of Chief Counsel
1111 Constitution Ave. NW
Room 5111
Washington, DC 20224

RE: Audit Technique Guide, Section 42, Low-Income Housing Credit – Relocation Costs

Dear Mr. Handleman:

The LIHTC Working Group was established to provide a platform for low-income housing tax credit (“LIHTC”) industry participants to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we are requesting further guidance on tenant relocation costs as discussed in Appendix C of the Audit Technique Guide, Section 42, Low-Income Housing Credit (the “Guide”) released in September 2014.

In general, eligible basis for LIHTC projects is the cost of new construction, acquisition of existing property and the costs of any improvements to that property.¹ In determining costs, eligible basis generally equals the adjusted basis of the property, with some exceptions.² In many rehabilitation projects, where an occupied building is being acquired and rehabilitated under the LIHTC program, all or a portion of the units need to be vacated in order to complete the rehabilitation of the building. The project owner may be required to pay existing tenants a to-be-determined sum as compensation for their forced relocations and/or incur third-party costs and fees to relocate tenants during the rehabilitation of the building. This raises the issue of how relocation costs should be treated for eligible basis purposes.

The Guide’s current position on tenant relocation costs when a structure is demolished is as follows:

IRC §280B states that in the case of the demolition of any structure, no deduction is allowed to the owner or lessee of such structure for any amount expended for the demolition, or any loss sustained on account of the demolition. The costs should be added to the capital account for the land on which the demolished structure was located. Therefore, these costs are excluded from eligible basis. The costs of relocating tenants

¹ Joint Committee Report on the LIHTC, page 157

² IRC Section 42(d)(1) and 42(2)(A)(i)

*out of an acquired building that will be demolished may be associated with the demolition and, if so, are capitalized to the land.*³

IRS guidance corresponds to the position taken in the Guide, which states in Revenue Ruling 70-473, relocation allowances required to be paid to the owner-occupants and tenants of the dwellings to be razed in connection with an urban renewal program were considered additional costs of the land that are to be capitalized and are not deductible as ordinary and necessary business expenses under section 162(a) of the Internal Revenue Code Section (“IRC”).⁴

Furthermore, the Guide’s current position on tenant relocation costs when a structure is not demolished is as follows:

Cost Incurred to Permanently Relocate Nonqualifying Tenants: *A determination may be made that an existing tenant is not a qualified low-income household. In which case, the taxpayer may decide to move the tenant out of the unit permanently. In some cases, the taxpayer may rehabilitate the vacant unit. The costs attributable to moving out the tenant permanently (e.g.; legal costs, tenant moving expenses, and compensation paid to the tenant) are expensed as an ordinary and necessary business expense under IRC §162, even if the vacated unit is rehabilitated.*

Costs Incurred to Temporarily Relocate Qualifying Tenants During the Rehabilitation: *A determination may be made that an existing tenant is a qualified low-income household. In which case, the taxpayer will move the tenant and provide temporary housing while the tenant’s unit is being rehabilitated. The temporary housing may be another unit within the project or off-site. The tenant is expected to occupy the rehabilitated unit after the rehabilitation is completed. The costs attributable to moving the tenant and providing temporary housing for the tenant during the rehabilitation (e.g.; legal costs, tenant moving expenses, costs for temporarily storing a tenant’s property, and temporary housing costs) are expensed as ordinary and necessary business expenses under IRC §162.*⁵

However, in accordance with Revenue Procedure 95-27, if a modification to an existing building leaves 75% or more of the existing external walls in place as external or internal walls, 75% or more of the existing structural framework is retained in place, and 75% or more of the existing internal structural framework of the building is retained in place, then such a modification would not be treated as a demolition for the purposes of IRC 280B. Since the IRS has ruled that government-mandated payments made to occupants of a to-be-demolished building as compensation for their relocations should be capitalized (albeit in the particular ruling to the basis of the land), it is probable that all or part of the relocation payments would have been

³ Audit Technique Guide, Section 42, Low-Income Housing Credit, Appendix C, page C-4 (released September 2014)

⁴ Revenue Ruling 70-473

⁵ Audit Technique Guide, Section 42, Low-Income Housing Credit, Appendix C, page C-10 (released September 2014)

allocated to a depreciable building rather than to non-depreciable land if the cited ruling had related to a rehabilitation meeting the requirements under the revenue procedure rather than demolition.

In addition, under IRC 263A taxpayers must capitalize all direct and certain indirect costs properly allocable to real property and tangible personal property produced by the taxpayer.⁶ Indirect costs are properly allocable to property produced when the costs directly benefit or are incurred by reason of the performance of production.⁷ Thus, costs to relocate tenants from a building incurred solely by reason to rehabilitate the building should be capitalized as an indirect cost to the building under IRC 263A.

We request that the IRS re-evaluate the guidance in the Guide addressing the treatment of relocation costs incurred for the rehabilitation of a building under the LIHTC program as various sections in the Guide seem contradictory with one another. Based on the aforementioned, the costs to relocate tenants from a building incurred solely by reason to rehabilitate the building should be capitalized as an indirect cost to the building under IRC 263A, and thus be includible in eligible basis under IRC 42.

We appreciate the opportunity to comment on this issue. The furtherance of this issue will help the LIHTC program better provide affordable housing and help increase the number of jobs in our communities by providing clarification and lessening the risks in the LIHTC program compliance. Thank you in advance for your time and careful consideration of this issue. Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

THE LIHTC WORKING GROUP

Very truly yours,

NOVOGRADAC & COMPANY LLP

NOVOGRADAC & COMPANY LLP



by

Michael J. Novogradac

by

Stacey Stewart

⁶ Regulation Section 1.263A-1(a)(3)(ii)

⁷ Regulation Section 1.263A-1(e)(3)(i)(A)