

CHAPTER 10 – NONCOMPLIANCE AND DISPOSITIONS

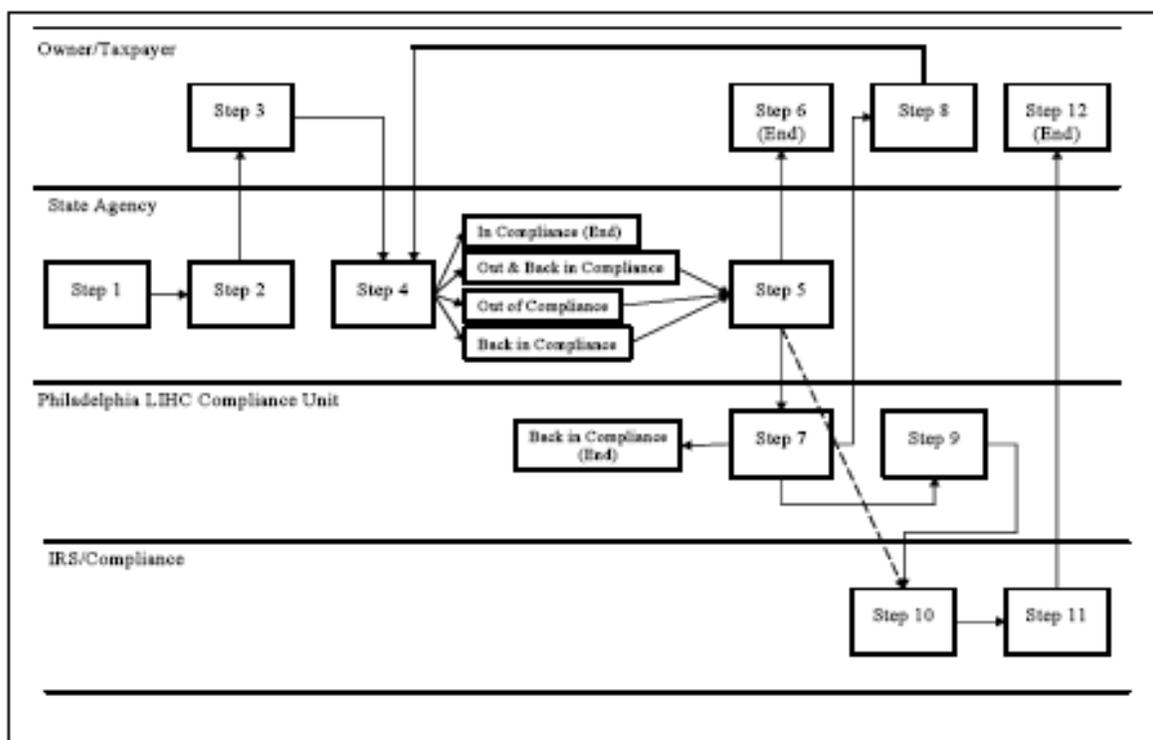
Portions of this Chapter of the Compliance Manual were taken in part or in entirety from the 8823 Guide (January 2011 edition), which is discussed in [Part 1034](#).

Section 10A – Process Overview

Part 1000 : Overview of the Noncompliance Process

The following chart is contained in the IRS 8823 Guide.

**Reports of Noncompliance (Form 8823)
Process Map & Explanations**



The chart above is a process map demonstrating the steps of the Form 8823 process. The map is divided into four horizontal paths representing the groups involved in the process. The steps of the process are placed in the path of the group involved as the steps move from left to right across the map. The top path is for the owner/taxpayer, the second path down is for the state agency, the third path down is for the Philadelphia LIHC Compliance Unit, and the bottom path is for IRS/Compliance.

Step 1 Compliance Review (8823 Guide)

The state agency performs a desk audit, conducts a site visit, or reviews the owner's tenant files.

MSHDA Policy/Procedure

Desk audits include such activities as reviews of tenant data submitted via MSHDA's On-Line Tenant Data Reporting System and reviews of annual compliance certifications. Site visits include physical inspections and file audits.

Step 2 Summary Report / Notification Letter (8823 Guide)

The state agency prepares and promptly provides the Owner with a summary report describing issues of noncompliance. The letter may also identify administrative or technical issues, recommend changes to improve future management of the property, or suggest corrective actions to remedy noted noncompliance issues.

MSHDA Policy/Procedure

Some of the specific notification letters and summary reports used by MSHDA include the File Audit Report (discussed in [Part 720](#)), Hazard Notices (discussed in [Part 744](#)), and the Physical Inspection Report (discussed in [Part 746](#)).

If the Owner or Management Agent becomes aware of any noncompliance with the LIHTC program requirements, the Low Income Housing Tax Credit Compliance Monitoring staff must be notified immediately. This includes noncompliance that is egregious or that the Owner will not be able to remedy in a timely manner.

Types of noncompliance are discussed in greater detail in [Part 1006](#). Some building dispositions and ownership changes are also reported to the IRS, as discussed in [Part 1014](#).

Step 3 Corrective Actions / Correction Deadline / Owner's Response (8823 Guide)

The Owner responds to the state agency within a maximum of 90 days, which can be extended up to a total of 6 months with the state agency's approval. Generally, the state agency specifies a time period appropriate for the type of noncompliance. The owner's response may provide clarifications and document that corrective actions have been implemented; i.e., how the noncompliance issues have been addressed.

MSHDA Policy/Procedure

Corrective actions are discussed in greater detail in [Part 1036](#).

The Correction Period for deficiencies identified at physical inspections is discussed in [Part 750](#). The Correction Period for violations cited at tenant file audits is discussed in [Part 722](#). The Correction Period for various other types of issues will be specified in a noncompliance notification letter sent by MSHDA to the owner. The three year post-8823 correction period is discussed in [Part 1002](#).

The required format for the Owner's response to findings identified at tenant file audits is discussed in [Part 722](#) (Owner's Response to Audit Report). The required format for the owner's response to violations identified at physical inspections is discussed in [Part 748](#) (Owner's Physical Inspection Response).

Step 4

MSHDA's Review of Owner's Response (8823 Guide)

When the owner's response is received, the state agency determines whether the owner provided:

- A. *{No Noncompliance}* - clarification establishing that the Owner was always in compliance,
- B. *{Corrected Noncompliance}* - documentation that issue(s) of noncompliance have been remedied within the correction period (out and back in compliance).
- C. *{Uncorrected Noncompliance}* - no documentation that issue(s) of noncompliance had been remedied within the correction period (out of compliance), or
- D. *{Subsequent Corrective Actions}* - documentation that issue(s) of noncompliance have been remedied, but the noncompliance was not corrected until after the end of the correction period. A Form 8823 had been submitted to the IRS only to report the correction of previously reported noncompliance (back in compliance).

MSHDA Policy/Procedure

For certain types of violations (i.e. UPCS physical inspection deficiencies), regardless of whether the owner remedied the noncompliance or remains out of compliance, a Form 8823 must be filed with the IRS.

For information about subsequent corrective actions, see [Part 1002](#) (The Three-Year Post-8823 Correction Period).

Step 5

Issuance of IRS 8823 Form(s) (8823 Guide)

If the state agency determines that the Owner was always in compliance, findings are not required to be reported to the IRS. However, the state agency should notify the Owner that the issue is considered closed and no Form 8823 will be filed. If the state agency determines that either the Owner remedied the issue of noncompliance or remains out of compliance, then a Form 8823 must be filed with the Internal Revenue Service at the Philadelphia Service Center (PSC). As noted by the dashed line between steps five and ten, the state agency may send a copy of the Form 8823 directly to IRS Headquarters.

Step 6

Copy of 8823 Form is Sent to the Owner (8823 Guide)

The state agency sends the Owner a copy of the Form 8823 at the same time it files the Form with the IRS.

- Step 7** 8823 Form Processed by the IRS (8823 Guide)
PSC (Philadelphia Service Center) processes the “back in compliance” forms 8823 without contacting the Owner. The “out of compliance” Forms 8823 are assigned to technicians to prepare owner notification letters. The letters are tailored to the type of noncompliance reported on Form 8823, and explain that noncompliance may result in the loss and recapture of the tax credit.
- MSHDA Policy/Procedure
Consequences of and penalties for noncompliance are discussed in greater detail in **Part 1010**.
- Step 8** IRS Sends Notification Letter to the Owner (8823 Guide)
The Owner receives the notification letter. The letter instructs the Owner to contact the state agency to resolve the issue (Step Four). If the noncompliance is resolved within three years, a “back in compliance” Form 8823 must be filed with the IRS and a copy sent to the owner concurrently. (Note: some issues of noncompliance cannot be remedied.)
- Step 9** IRS 8823 database (8823 Guide)
Simultaneous to notifying the Owner, the PSC processes the Forms 8823 and transcribes the information into a database.
- Step 10** Audit Determination by IRS (8823 Guide)
Forms 8823 are immediately evaluated when received from the state agencies and IRS databases are routinely analyzed to determine whether an audit of the Owner’s tax return is needed. The taxpayer’s three latest filed income tax returns and all Forms 8823 filed for the property are evaluated.
- Step 11** IRS examination of case file (8823 Guide)
If it is determined that an audit is warranted, the case file is sent to the appropriate field office for examination.
- Step 12** Scheduling of audit by IRS (8823 Guide)
The taxpayer is notified that an audit has been scheduled.

The IRS 8823 Guide is discussed in greater detail in **Part 1036**.

Part 1002 :: The Three-Year Post-8823 Correction Period

Under Treas. Reg. Section 1.42-5(e)(3), if the noncompliance is corrected within three years, the state agency will file another Form 8823 reporting that the noncompliance has been corrected and documenting the date the taxpayer was back in compliance. The three year period begins on the first day after the end of the original correction period, not including extensions.

The Three-Year Post-8823 Correction Period applies only to LIHTC projects.

1. Training, training and more training. Leasing and compliance staff need on-going training to remain up to date with HUD 4350.3, UPCS, IRS, and MSHDA changes.
2. Find Noncompliance and Correct It (before audits, inspections, etc.). As a general (but not absolute) rule, MSHDA will not issue 8823 for noncompliance corrected prior to the date a tenant file audit or physical inspection is scheduled.
3. Correct Noncompliance found in MSHDA file audits, physical inspections and desk reviews in a timely manner.

The Owner/Management Agent can also contact the MSHDA Office of Compliance Monitoring at (517) 241-2560 for assistance meeting the LIHTC program requirements.

Section 10B – Types of Noncompliance

Part 1006 : Types of Noncompliance

Noncompliance is a period of time a development, specific building, or unit is ineligible for tax credits because of failure to satisfy LIHTC Program requirements. Instances of noncompliance that could be reported to the IRS include but are not limited to:

1. Any violation of the Internal Revenue Code;
2. Any violation of the Restrictive Covenant;
3. Any violation of federal, state or local building health or safety codes.

Generally, during the Compliance Period, a project is out of compliance if:

- A. A building or an ownership interest in a building is disposed of (see **Part 1014**);
- B. There has been a change in the applicable fraction or eligible basis that results in a decrease in the qualified basis of the building from one year to the next;
- C. The building no longer meets the minimum set-aside requirements of Section 42(g)(1), the gross rent requirements of Section 42(g)(2), or the other requirements for the units that are set-aside;
- D. It fails to submit the annual utility allowance documentation, owner certification along with any applicable supporting documentation, on-line tenant data reporting or compliance monitoring fees, in a timely manner;
- E. A federal grant is obtained that results in a decrease in eligible basis (see 26 CFR 1.42-16);
- F. A Qualified Nonprofit Organization fails to materially participate in a LIHTC project for which nonprofit participation is required;
- G. It fails to properly document the eligibility of tenants to reside in LIHTC units;
- H. It fails to implement changes in utility allowances;
- I. It incurs health, safety or building code violations; or
- J. Casualty losses are not remedied or replaced within a reasonable period of time; or
- K. It fails to properly restrict tenant rents by charging a tenant a rental amount that exceeds the LIHTC limits.

Part 1008 : Tenant Misrepresentation and Fraud

Owners should demonstrate due diligence to prevent tenant fraud when determining eligibility. Deliberate misrepresentation on the part of a tenant can result in the Owner renting a unit to an ineligible tenant. If an Owner discovers that a tenant has deliberately misrepresented one or more eligibility factors, the Owner should consult landlord-tenant law to determine if the household may be compelled to move. Alternatively, in mixed use projects (i.e. projects that have an applicable fraction of less than 100%), the resident may be re-designated as a market rate household and the household's rent may be raised to market rate.

The IRS has stated that if an Owner corrects an issue of fraud and notifies their housing finance agency (MSHDA), the property will not be reported as out of compliance. If the housing finance agency discovers the fraud, then an 8823 must be filed. This encourages Owners to be proactive in discovering and resolving noncompliance prior to an agency audit.

Chapter 25 of the IRS 8823 Guide (discussed in [Part 1036](#)) contains a detailed discussion of tenant misrepresentation or fraud.

Section 10C – Consequences of Noncompliance

Part 1010 Consequences

As stated in the IRS 8823 Guide, “if the state agency reports that the owner is out of compliance, the IRS sends a notification letter to the owner identifying the type of noncompliance reported on Form 8823. The notification letter also states that the owner should not include any nonqualified low income housing units when computing the tax credit under IRC §42 and that the noncompliance may result in the recapture of previously claimed credits. The notification letter also instructs the owner to contact the state agency to resolve the issue.”

If the project is out of compliance, a penalty could apply to all units in the project. Possible penalties include, but are not limited to:

- A. Recapture of the accelerated portion of the tax credit for prior years (IRC 42(j)(3)) (discussed further in [Part 1012](#));
- B. Disallowance of the credit for the entire year in which the noncompliance occurs;
- C. Assessment of interest for the recapture year and previous years;
- D. Notification to IRS;
- E. Issuance of negative points in future tax credit funding rounds for applicants, their partners or members, management agents or related entities, for poor previous participation on the part of the sponsor or the management agent. This will be in effect for a time period of three years;
- F. Rejection of future applications. Proposals submitted from sponsors that currently have projects that are out of compliance will not be accepted until the noncompliance is corrected;
- G. Potential audit by the IRS (discussed further below);
- H. Fees for noncompliance may be assessed in certain circumstances, as discussed in [Part 730](#) (File Audit Noncompliance Fees) and [Part 760](#) (Fees for Physical Inspection); and/or
- I. Removal from the LIHTC program (discussed in [Part 1026](#)).

Potential Audit of the Owner by the IRS

The IRS 8823 Guide states the following:

Forms 8823 are routinely analyzed by the IRS. Based on categories of noncompliance, and without regard to subsequent “back in compliance” Forms 8823, taxpayers are evaluated to determine whether an audit of the owner’s tax return is needed. The taxpayer’s tax returns and all Forms 8823 filed for the property are evaluated. If it is determined that an audit is warranted, the complete file is sent to the appropriate IRS field office. The taxpayer is then notified that an audit has been scheduled. It should be noted that this is not the only method for selecting which low-income housing credit tax returns to audit and, at the examiner’s discretion, the audit may be expanded to include additional issues or tax returns.

A copy of a sample form IRS 8823 (Report of Noncompliance) is available on the MSHDA website.

Note: For tax-exempt bond projects, possible penalties for noncompliance include:

- Bonds could lose tax-exempt status retroactively to the date of noncompliance.
- Bonds may be subjected to early prepayment in full.
- Project loans may be declared in default and foreclosure proceedings initiated.
- Legal action may be initiated against non-complying projects and/or Owners barred from further financing with the Authority. The Owner will be responsible for all costs of such legal action.
- MSHDA Direct Loan projects could lose eligibility for premium management fee.

Part 1012 **Recapture**

Recapture is defined as an increase in the Owner's tax liability because of a loss in tax credits due to noncompliance with program requirements. Interest may also be assessed by the IRS in recapture situations.

The IRS will make the determination as to whether or not the Owner faces recapture of tax credits as a result of noncompliance.

IRS Form 8611 is used by taxpayers who must recapture tax credits previously claimed. A copy of IRS Form 8611 must be sent to the IRS and MSHDA upon completion by the owner. A copy of form IRS 8611 (Recapture of Low-Income Housing Credit) is available on the MSHDA website.

For information about the 1602 Program and recapture provisions and noncompliance in that program, see [Chapter 11](#) (1602 Program – Documents).

Section 10D – Building Disposition and/or Change in Ownership (Participation in the LIHTC Program Continues)

This Section of the Compliance Manual is intended only to provide a brief, generalized description of the requirements for selling or withdrawing LIHTC projects. The owner should consult an attorney or other professional knowledgeable about the LIHTC program for advice and guidance concerning sales.

Part 1014 : Overview of Change of Ownership, Sale, Transfer, or Disposition of the Project after the Placed-in-Service Date

Recapture of the accelerated portion of credits may be caused not only by noncompliance with the LIHTC program requirements, but by either the sale or other disposition of a LIHTC building or the sale of an ownership interest in such a building. The amount of the repayment is equivalent to approximately 1/3 of the credits claimed on the project.

In general, per IRC Section 42(j)(6), there is no recapture when a disposed of building continues to be operated as a qualified use. It is important to report all dispositions of low-income buildings that will *not* continue to be operated as a qualified low-income building after the disposition so that the IRS can determine whether the taxpayer has complied with the requirements of IRC Section 42(j); i.e., or if the credits have been appropriately recaptured. Recapture provisions are discussed in IRC Section 42(f)(4) and Rev. Rul. 91-38, 1991-26 I.R.B. 5, Q&A #5.

Types of activities that would constitute a “sale” (which do not necessarily involve the seller receiving money) include:

- Fee Title Sale of Building - Fee title passes from the seller to a whole new entity (buyer) – see [Part 1016](#).
- Termination of Partnership – see [Part 1020](#).

Other types of disposition or related events include the following:

- Foreclosure (discussed in [Part 1030](#)); and
- Destruction (discussed in [Part 1032](#)).

For related discussions, see the following:

- [Part 220](#) (Contact Information Must be Up To Date)
- [Part 766](#) (Casualty Loss)
- [Part 902](#) (Terminating the Extended Use Period)
- [Part 906](#) (Qualified Contract)
- [Part 1022](#) (Notifying MSHDA about Building Disposition and/or Change in Ownership)
- [Part 1026](#) (Removal from LIHTC Program for Noncompliance); and
- [Part 1028](#) (Project No Longer Participating in the LIHTC Program).

Part 1016 **Fee Title Sale of Building / Transfer of Ownership**

A Fee Title Sale of a Building is a situation in which the fee title passes from the seller to a whole new entity (buyer). An example of an Owner selling a LIHTC building is as follows:

ABC, a limited partnership, owns and operates a LIHTC building, and is identified as the owner on Form 8609. Mr. Jones is the general partner. There are two limited partners, Mr. Smith and the XYZ investment fund. ABC sells the building to E&F, a limited partnership, which intends to continue operating the building as a LIHTC building. As required in the extended use agreement, the state agency approved the sale. The state agency is required to report the disposition on Form 8823.

Project Continues to Be Operated as a LIHTC Development

When a sale occurs, the Owner must submit the following to the Compliance Section of MSHDA within five (5) business days of the transaction:

- A. An executed copy of the purchase agreement;
- B. Recorded Statutory Warranty Deed indicating ownership or a copy of the title policy indicating ownership;
- C. A copy of the IRS 8611, Recapture of Low-Income Housing Credit, if applicable;
- D. A letter from the previous owner notifying MSHDA that a change in ownership has occurred and whether or not the new owner intends to continue to operate the building as a qualified low-income building after the disposition.
- E. A Notice of Change in Ownership form and a cover letter from the new owner indicating whether or not the new owner intends to continue to operate the building as a qualified low-income building after the disposition.
- F. A Notice of Change in Management Agent form, if applicable
- G. Any other reasonable evidence that MSHDA may deem necessary.

H.R. 3221 (Sec 3004) eliminates the previously mandated bond posting requirement, which required completion of IRS for 8693 (Low Income Housing Credit Disposition Bond). Owners of developments sold before the end of the compliance period will no longer be required to obtain a recapture bond, if the project will remain a tax credit project and owners agree to extend the statute of limitations on their tax returns.

For additional procedural information about sales, see **Part 1022** (Notifying MSHDA about Building Disposition and/or Change in Ownership).

Project Will Not Continue to Be Operated as a LIHTC Development

If the building(s) will not continue to be operated as a LIHTC project, see **Part 1028** (Withdrawal from LIHTC Program.)

Part 1018 **Change in the Composition of Ownership Entity**

LIHTC buildings are generally owned by partnerships and identifying changes in the composition of the ownership entities is not required for compliance monitoring purposes. However,

MSHDA requires it for other purposes unrelated to compliance monitoring, as discussed in [Part 1024](#) (Limited Dividend Housing Associations).

(The following example was taken from the IRS 8823 Guide.)

Example 3: State Agency reviews Owner's Annual Certification of ABC, a limited partnership. ABC owns and operates a LIHTC building, and is identified as the owner on Form 8609. Mr. Jones is the general partner. There are two limited partners, Mr. Smith and the XYZ investment fund. As part of the regular monitoring procedures, the state agency reviews the owner's annual certification to confirm that ownership has not changed. The state agency is not required to ask whether Mr. Jones, Mr. Smith, or XYZ has disposed of their interest (or a portion of their interest).

For additional procedural information about changes in the composition of the ownership entity, see [Part 1022](#) (Notifying MSHDA about Building Disposition and/or Change in Ownership).

Part 1020 **Termination of Partnership**

IRC Section 42j

Exhibit 24-1 (Explanation of Credit Recapture Requirements under IRC Section 42(j)) of the IRS 8823 Guide contains a detailed description of rules and regulations regarding the termination of a partnership that has an ownership interest in a LIHTC project.

For additional procedural information about partnership terminations, see [Part 1022](#) (Notifying MSHDA about Building Disposition and/or Change in Ownership).

Part 1022 **Notifying MSHDA about Building Disposition and/or Change in Ownership**

When notifying MSHDA of the intent to sell or completion of a sale of a tax credit project, the current owner must include the buyer's contact information and whether or not the buyer intends to continue operating the project as a LIHTC development.

MSHDA will recognize a new partner or ownership entity only after all the required documentation has been submitted. Until such time, all compliance requirements will be the responsibility of the owner of record and any compliance violations will be reported to the IRS under the name of the owner of record. The IRS has also suggested in Reg. 1.42-5 that, if a building is sold or otherwise transferred by the Owner, the transferee should obtain from the transferor all information related to the first year of the credit period so the transferee can substantiate credits claimed. For a related topic, see [Part 220](#) (Contact Information Must Be Up-to-Date).

A Notice of Change in Ownership for LIHTC Developments form, which is available on the MSHDA website, must be submitted to the MSHDA Compliance Section. Limited Dividend Housing Associations (LDHA) have additional notification and approval requirements for certain changes, as discussed in [Part 1024](#).

MSHDA will report dispositions of LIHTC projects to the IRS as required.

In addition to the notification requirements discussed in Part 1022, most changes in the LDHA must be pre-approved by the Legal division of MSHDA. Documents (or drafts of such) include the following:

For transfer of ownership and for change in partnership name

- Copy of the amended or new partnership agreement; or
- Copy of the Articles of Incorporation and By-Laws; or
- Copy of the LLP/LLC Organizational Documents; and
- Copy of the Certificate of Good Standing from the Michigan Secretary of State that is no older than 90 days from the date of the notice, if applicable.
- Notice of Change in Ownership form

Additional submissions for transfer or change of ownership

- Copy of the purchase agreement
- Copy of the recorded contract for deed or warranty deed transferring the benefits and burdens of ownership of the buildings to the purchaser, or title policy indicating ownership
- Notice of Change in Ownership form

Section 10E – Removal and Withdrawal from the LIHTC Program (Voluntary and Involuntary – Participation Does Not Continue)

Additional topics related to those discussed in this Section include the following:

- Qualified Contract ([Part 906](#))
- Terminating the Extended Use Period ([Part 902](#))
- Year 15 and After the LIHTC Compliance Period Ends ([Part 166](#)).

Part 1026 : Removal from the LIHTC Program

The determination that a LIHTC building is entirely out of compliance and will not be in compliance at any time in the future is a recapture event under IRC Section 42(j). If MSHDA determines that a project is no longer in compliance with the LIHTC program requirements, and thus, is no longer participating in the program, MSHDA may remove the project from the program. Buildings removed from the LIHTC program are no longer considered to be a qualified low-income building under IRC Section 42(c)(2)(A) and no credit is allowable in the remaining years of the credit period,

A list of circumstances that could result in the owner/project's removal from the LIHTC Program includes but is not limited to the following:

1. Egregious Noncompliance with Program Requirements. This involves noncompliance that is conspicuous, flagrant, and systemic in nature and includes the failure to make reasonable attempts to comply with the requirements of the LIHTC program, or careless, reckless, or intentional disregard of program requirements.
2. Failure to Respond to Repeated Requests for Reports, Certifications, Reviews, Audits, Inspections, or Other Essential Communication. The date of noncompliance is the first day of the first year that the Owner failed to provide annual reports or certifications or did not respond to a request for the physical inspection or file audit of the property.
3. The Building(s) is No Longer Participating in the Low-Income Housing Program. This can include the conversion of the building to entirely market-rate occupancy (or leasing in entirety to unqualified or uncertified tenants) or to another use that is not LIHTC-eligible.
4. Failure to provide up-to-date contact information, making it impossible for MSHDA to contact the owner of the project for an extended period of time.

Prior to removing an owner/project from the LIHTC Program, MSHDA will attempt to give the owner an opportunity to respond, provide an explanation and correct the noncompliance. The reasonableness of the explanation will be evaluated for credibility, the presence of corroborative or contradictory evidence, and/or collateral evidence from third party sources.

MSHDA determines whether and when it is appropriate to release the Regulatory Agreement, as discussed in [Part 164](#).

The Three-Year Tenant Protection Period (discussed in [Part 904](#)) applies if a project is removed from the LIHTC program. The Three-Year Tenant Protection Period begins on the date specified by MSHDA in a written notice to the Owner that MSHDA has removed the project from the LIHTC Program. Until the Owner receives the written notification, the project will remain bound by its Regulatory Agreement.

Part 1028 **Owner Permanently Withdraws Project from the LIHTC Program**

When an Owner voluntarily withdraws a property from the LIHTC program and retains ownership during the 15-year initial compliance period or at any time during the extended use period, noncompliance and potential recapture occurs. The building(s) still exists physically, but is/are not being operated as a LIHTC property. For example, the Owner may have converted the entire building to a use other than as an LIHTC housing project or 100% of the units may be vacant (and the owner has no intention of renting any of the units in the future).

The Owner must first receive permission from MSHDA prior to withdrawing from the LIHTC Program or converting the building to a non-LIHTC eligible use. The Owner's written request must indicate why the property was withdrawn and identify the last year the property was in service. MSHDA will issue an IRS 8823, Report of Noncompliance. The IRS will determine whether the Owner's tax return properly reflected recaptured accelerated credits.

MSHDA will determine whether and when to release the Restrictive Covenant/Regulatory Agreement, as discussed in [Part 902](#) (Terminating the Extended Use Period).

The Three-Year Tenant Protection Period (discussed in [Part 904](#)) applies if an Owner withdraws a project from the LIHTC program. The Three-Year Tenant Protection Period will begin on the date specified by MSHDA in a written notification to the Owner that MSHDA has approved the project's withdrawal from the LIHTC Program. Until the Owner receives the written notification, the project will remain bound by its Regulatory Agreement.

For related discussions, see [Part 1030](#) (Foreclosure) and [Part 1032](#) (Destruction).

Part 1030 **Foreclosure**

IRC 42(h)(6)

Foreclosure is the legal process whereby a lender terminates the borrower's interest in a property after the borrower defaults on a mortgage loan. Upon foreclosure, the Owner is deemed to have made conveyed the property for the outstanding amount of the mortgage debt.

The following example appears in the IRS 8823 Guide:

Owner Loses Ownership in a Foreclosure Proceeding - FGH, a limited partnership, owns and operates a LIHTC building, and is identified as the owner on Form 8609. Mr. Jones

is the general partner and the limited partner is the XYZ investment fund. On December 1, 2008, the partnership lost ownership of the building in a foreclosure proceeding. The new owner will not operate the building as a qualified low-income building. The state agency is required to report the disposition on Form 8823.

A Deed of Property in Lieu of Foreclosure occurs when the Owner voluntarily conveys the property to the mortgage holder to avoid further foreclosure proceedings.

In the event of a foreclosure, a copy of the Deed in Lieu of Foreclosure or the Sheriff's Deed of Mortgage Sale (or similar official document) must be submitted to MSHDA as soon as it is issued. At the end of the Redemption Period, the new owner must submit receipt of written notification (i.e., generally the bank or other mortgage holder) that the property was not redeemed. MSHDA will generally release the Regulatory Agreement after the three year tenant protection period has ended, or when all of the tenants residing in the development on the date of the foreclosure (date of Sheriff's Deed or Deed in Lieu of Foreclosure date) have vacated the property, whichever occurs first.

For a related discussion, see [Part 902](#) (Terminating the Extended Use Period). For additional procedural information about foreclosures, see [Part 1022](#) (Notifying MSHDA about Building Disposition and/or Change in Ownership).

The Three-Year Tenant Protection Period (discussed in [Part 904](#)) applies in foreclosure situations. Recapture provisions and other consequences (discussed briefly in [Parts 1010](#) and [1012](#)) may apply in foreclosure situations.

Part 1032 **Destruction**

Destruction is related to a building's *physical structure*, and not to the ownership interest in the building. The destruction affects the building *in its entirety*, i.e., the eligible basis of the building is reduced to \$0. The destruction is *permanent* and the building is not expected to operate as a tax credit project again.

Violations of the physical inspection standards or casualty losses that are temporary in nature are not "destruction", which is permanent. Physical inspection violations are discussed in [Part 734](#) (Physical Condition Standards). **Casualty losses** are discussed in [Part 766](#).

Recapture provisions and other consequences (discussed briefly in [Parts 1010](#) and [1012](#)) may apply in destruction situations.

The Owner/Management Agent must immediately notify MSHDA in writing when destruction occurs.

Section 10F – IRS 8823 Guide and Methods of Correcting Noncompliance

Part 1034 : IRS 8823 Guide

The IRS 8823 Guide provides standardized operational definitions for the noncompliance categories listed on Form 8823. MSHDA uses the Guide for Completing Form 8823 (Low Income Housing Credit Agencies Report of Noncompliance or Building Disposition). The MSHDA website (discussed in [Part 202](#)) contains a link to the IRS 8823 Guide.

As of the date of the issuance of this Compliance Manual, the most current version of the IRS 8823 Guide is dated January 2011.

Part 1036 : Methods of Correcting Noncompliance

MSHDA has adopted the guidelines for correcting noncompliance that are outlined in the IRS 8823 Guide. The MSHDA website (discussed in [Part 202](#)) contains a link to the IRS 8823 Guide.

The Owner should be aware that certain types of noncompliance are uncorrectable. Further, some types of noncompliance are required to be reported to the IRS, regardless of whether it is subsequently corrected and regardless of the severity of the issue.

Part 1038 : Differences

The following is a list of areas in which MSHDA's policy and/or procedures differ from the 8823 Guide.

Chapter 4, Category 11a (Housing Income Above Income Limit upon Initial Occupancy)

- Verifying Income and Assets - Similar, except Michigan does not permit use of the Under \$5,000 Asset Certification form at initial move-in or for the first annual recertification.
- Determining Annual Income - Similar, except Michigan does not permit use of the Under \$5,000 Asset Certification form at initial move-in or for the first annual recertification.

Chapter 5, Category – 11b – Owner Failed to Correctly Complete or Document Tenant Annual Income Recertification

- Differs Somewhat – The IRS 8823 Guide states that the effective date for recertification continues to be the anniversary of the actual date of move-in. However, MSHDA requires the recertification date to be 12 months (365 days) or less. For example:

The Thompson household moved into ABC Apartments (a LIHTC development) on July 2, 2010, at which time an initial eligibility certification was conducted. ABC Apartments conducts a mass recertification of all of its tenants, including the Thompson household, on January 1, 2011. The January 1, 2011 recertification meets MSHDA's requirement that the household be certified at least once during every twelve months period. MSHDA does not require a second recertification on July 2, 2011, the anniversary of the household's move-in.

Chapter 14, Category 11i – Violations of the Available Unit Rule

- Differs Somewhat – MSHDA requires pre-approval to eliminate recertification. MSHDA also requires a full certification with third party verifications be completed on the first anniversary of the initial (move-in) certification and annual self-certifications thereafter. MSHDA requires tenant data to be reported on-line through the on-line tenant data reporting system.