NAHB National Association of Home Builders

September 3, 2015

The Credential

An In-Depth Look

Casualty Losses and Ability to Claim Low-Income Housing Tax Credits

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Generally, a building will be subject to low-income housing tax credit (LIHTC) recapture if, as of the close of any taxable year after the first year in the compliance period, the qualified basis of the building is less than it was as of the close of the prior tax year. An exception to this rule exists if the reduction in qualified basis results from a casualty loss, and the loss is restored by replacement or reconstruction within a reasonable period of time, as determined by the Secretary of the Treasury.

A casualty is damage, destruction or loss of property resulting from an identifiable event that is sudden, unexpected or unusual. Property damage that occurs as a result of normal use, neglect, or is progressive over time will not be considered a casualty loss.

Upon the reduction in qualified basis due to a casualty loss, the first two questions that a building owner typically asks are:

(1) What happens to the LIHTCs during the restoration period?
(2) How quickly must the restoration be completed?

The answer to these questions depends on whether the building is located in a major disaster area or not. When a disaster warranting assistance from the federal government occurs, the Robert T. Stafford Disaster Relief and Emergency Assistance Act gives the President authority to issue a major disaster declaration for the affected area. Following the President's declaration, the Federal Emergency Management Agency (FEMA) may designate particular cities, counties, or other local jurisdictions covered by the declaration as eligible for individual assistance, public assistance or both. FEMA generally publishes this designation in a notice in the Federal Register.

If a building located in a FEMA-designated major disaster area suffers a reduction in qualified basis because of the major disaster, the building will not be subject to LIHTC recapture and may continue to claim LIHTCs during the restoration period. This assumes the building's qualified basis is restored within a reasonable period of time.

The determination of what is a reasonable period of time has been delegated to the governmental housing credit agency that has jurisdiction over the building. However, the time period may not extend beyond the end of the 25th month following the close of the month of the major disaster declaration. Please note that Revenue Procedure 2014-49 changed the allowable time period from what had been included in earlier technical guidance.

When calculating the allowable LIHTC amount during the reasonable restoration period, the building's qualified basis at the end of the taxable year immediately preceding the first day of the major disaster incidence period should be used. The rules are substantially different if a building suffers a reduction in qualified basis due to a casualty loss that is unrelated to the President's major disaster declaration, or the building is not located in a FEMA-designated major disaster area. Under one of these scenarios, as long as the building's qualified basis is restored within a reasonable period of time, the building will not be subject to LIHTC recapture. However, the building may not continue to claim LIHTCs while any rental units are out of service due to the casualty event. A reasonable period of time for the restoration of the building's qualified basis is 24 months from the end of the calendar year in which the casualty occurred.

Although the disparate treatment seems harsh, it is possible for a building suffering a reduction in qualified basis due to a casualty

loss not affected by a President's major disaster declaration to not lose any LIHTCs. This is due to the fact that LIHTCs are only determined on a monthly basis during the first year of the credit period. After the first year of the credit period, the test date for qualified occupancy is the last day of the tax year.

Therefore, if a building owner with a tax year ending December 31 were to suffer a casualty loss early in the tax year (other than the first year) and the restoration of the damaged units was completed prior to year end, the owner should be able to claim a full year of LIHTCs on the restored units. This assumes that all restored units are either occupied by qualified tenants or the owner can demonstrate continual and verifiable measures to rent restored vacant units to low-income tenants.

Conversely, if the owner failed to fully restore the damaged units by year end, no LIHTCs would be allowed on the units for the year. In either case, it is likely that the state agency will file Form 8823 with the IRS, because the units are temporarily not suitable for occupancy.

Depending on the fact pattern, an owner could either be entitled to a full year of LIHTCs or no LIHTCs on the damaged units. To the extent that LIHTCs are disallowed due to a casualty loss, there is no provision to allow for them to be claimed in a later year. Absent future guidance, they would appear to be lost forever. Prompt restoration of damaged units, ideally within the same tax year, is an owner's best response to a casualty event.

For additional information with respect to casualty losses, please refer to:

- Chief Counsel Advice Memorandum 200134006
- Revenue Procedure 95-28 – Effective for major disasters declared on or after Jan. 1, 1995
- Revenue Procedure 2007-54 – Effective for major disasters declared on or after July 2, 2007
- Chief Counsel Advice Memorandum 200913012
- Revenue Procedure 2014-49 – Effective for major disasters declared on or after Aug. 21, 2014.

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In his role with CohnReznick, Kimm works directly with developers and syndicators structuring affordable housing transactions. His experience includes preparation of financial projections for use by developers in seeking debt and equity financing using low-income housing tax credits and historic rehabilitation tax credits; preparation of 10% Tests, 50% Tests and 95/5 Tests and other Agreed Upon Procedure reports; preparation of financial projections for developers for use in the syndication of economic-based real estate transactions; tax compliance review of corporate fund limited partnership tax returns for a major national syndicator; addressing various issues regarding non-profit entities and tax-exempt use property rules; and writing various guides for internal use and articles for outside publications on current tax issues.