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**Community Development & Affordable Housing ALERT**

**February 2011** [www.ssd.com](http://www.ssd.com)

## Treatment of TCAP Grants and Allocations

### Introduction

Tax Treatment of TCAP and TCE Grants. The American Recovery and Reinvestment Tax Act of 2009 (P.L. 111-5) (Recovery Act) allocated funds for the Tax Credit Exchange (TCE) program and Tax Credit Assistance Program (TCAP) for capital investments in Low Income Housing Tax Credits (LIHTC) projects. The Department of Housing and Urban Development (HUD) awards TCAP funds to state housing agencies, which administer the TCAP program and award TCAP fund to individual LIHTC projects. The TCAP funds may be used for land costs and costs that are included in the eligible basis of a LIHTC project under Section 42 of the Internal Revenue Code (IRC). State agencies must execute a binding written agreement with each project owner receiving TCAP funds (TCAP Written Agreement). The state agency cannot withdraw funds from the US Treasury in advance of the need to pay for eligible costs, and once funds have been drawn from the US Treasury, they must be disbursed to a project owner for eligible TCAP costs within three days.

State housing agencies have the authority to distribute TCAP funds as loans or grants directly to project owners. However, prior to February 11, 2011 there was no direct guidance from the Internal Revenue Service (IRS) regarding (1) if TCAP grants were includable in the gross income of taxpayers, and, if so, (2) if the TCAP grants were includable in the taxable year awarded or the taxable year received.

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## February 11, 2011 OCC Memorandum

On February 11, 2011 the Office of Chief Counsel (OCC) of the IRS released Memorandum Number 201106008 entitled "Treatment of TCAP Grants and Allocations" (the Memorandum). The Memorandum makes the following determinations regarding TCAP grants:

1. TCAP grants are includable in a recipient's gross income for federal income tax purposes;
2. For taxpayers that utilize the cash receipts and disbursement method of accounting, TCAP grants are not includable in gross income until the taxpayer is able to draw upon the funds in the account set up by the state agency (i.e., after the US Treasury has deposited the funds in the state agency account and the taxpayer has access to the funds);
3. For taxpayers that utilize the accrual method of accounting, TCAP grants are not includable in gross income until all the events have occurred that fix (a) the right to receive such income and (b) the amount thereof that can be determined with reasonable certainty.

The Memorandum's conclusion with regard to taxpayers using the accrual method of accounting invites careful analysis.

### Analysis

To determine when TCAP grants are includable in gross income, taxpayers that utilize the accrual method of accounting must determinate when **all the events** have occurred that fix the right to receive such income. The Memorandum explains that all the events have occurred that fix the right to receive income upon the earliest of when (1) required performance takes place, (2) payment is due or (3) payment is made. The Memorandum concludes that all the events have occurred that fix the right to receive such income when "the project owner and the state agency execute the TCAP written agreement **unless the written agreement provides that the TCAP grant is due at another time** " (emphasis added). TCAP Written Agreements often require the state agency's consent to disbursement requests, the satisfaction of certain construction completion benchmarks and/or the closing of various third-party financing sources prior to the disbursement of all or a portion of the TCAP grant proceeds. Furthermore, as discussed above, the requirement to pay or reimburse land costs or basis eligible costs is a universal limitation on the right to

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receive TCAP grant income. The applicability of any of the aforementioned limitations should prevent the satisfaction of all the events necessary to receive the TCAP grant proceeds at the time of the execution of the TCAP Written Agreement and therefore delay the inclusion of the TCAP grant proceeds in the recipient's gross income.

The Memorandum does not specifically address the effect of ongoing limitations and/or recapture provisions that may be found in TCAP Written Agreements and may be effective throughout the 15-year compliance period or such longer periods as determined by the state agency. However, the Memorandum's conclusion that all the events have occurred that fix the right to receive such income upon execution of the TCAP Written Agreement "unless the written agreement provides that the TCAP grant is due at another time" suggests that the OCC believes the funds must be included in the recipient's gross income when the funds are *due* to the recipient. The existence of ongoing limitations and/or recapture provisions does not appear, in the IRS' view, to be enough to delay the inclusion of the TCAP grant proceeds in the recipient's gross income.

We believe that the Memorandum's guidance should also be applicable to the award of TCE funds. State housing agencies typically distribute TCE funds in the form of non-interest-bearing and non-repayable loans, except in the event of recapture during the 15-year compliance period. The IRS has issued guidance clarifying that the award of TCE funds generally will not be taxable to the recipient. However, TCE funds are income (just not taxable income) and, consequently, increase the partners' capital accounts and the basis in their partnership interests. The Memorandum's guidance regarding TCAP grant proceeds should also be applicable to the timing of the recognition of TCE income by the recipient and the increase in its partners' capital accounts and the basis of the partners' interests until **all the events** have occurred that fix the right to receive such proceeds or an installment thereof. This is consistent with Squire Sanders' historical position regarding the timing of the inclusion into income of TCE funds and reinforces our position that the recipient's investors must be admitted as partners prior to the satisfaction of the "all events" test in order to include their allocable share of TCE income in their capital accounts and bases.

## **Conclusion**

Even though the Memorandum has provided (a)

guidance regarding the inclusion of TCAP grants in a recipient's gross income and (b) a rather bright line rule for taxpayers that utilize the cash receipts and disbursement method of accounting, taxpayers that utilize the accrual method of accounting should continue to review when the "all events" test is satisfied for determining when the recipient should include the TCAP grant proceeds in gross income and, correspondingly, when the recipient's partners should include TCE funds in the basis in their capital accounts.

For more information on this topic, please contact your principal Squire Sanders lawyer or one of the individuals listed in this Alert.

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2011

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