



## Guidance on Low Income Housing Tax Credit (LIHTC) Nonprofit Material Participation

### Introduction

Section 42 of the Internal Revenue Code (“IRC”) requires that states set aside at least 10% of the federal 9% Credit for developments that involve a qualified nonprofit organization that owns an interest *and* materially participates in the development and operation of the projects. To meet the material participation requirement for housing credit projects incorporating a qualified nonprofit interest, **IRC Section 469(h)(1) requires that the nonprofit be “involved in the operations of the activity on a basis which is regular, continuous, and substantial.”** The failure of a nonprofit set aside to materially participate in a project is a reportable noncompliance event on Department of Treasury, IRS Form 8823.

This guidance provides guidelines and examples for determining what is “regular, continuous, and substantial” involvement by nonprofit set asides from Chapter 22 of the Guide for Completing Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition (“8823 Guide”), Sections 42 and 469 of the IRC and Treasury Regulation §1.469-5T, and input from a representative of the IRS LIHTC Program to MHDC on this topic. Ultimately, material participation seems best determined on a case-by-case basis but with some guidelines and parameters in mind.

### Material Participation Overview

First, according to the 8823 Guide, the best place to start with these guidelines is to look at the legislative history of the statute:

1. Material participation is most likely to be established in an activity that constitutes the principal business/activity of the taxpayer.
2. Involvement in the actual operations of the activity should occur. That is, the services provided must be integral to the operations of the activity. Simply consenting to someone else’s decisions or periodic consultation with respect to general management decisions is not sufficient.
3. Participation must be maintained throughout the year. Periodic consultation is not sufficient.
4. Regular on-site presence at operations is indicative of material participation.
5. Providing services as an independent contractor is not sufficient.

#### **A. Using rules for “individual” taxpayer material participation as a reference for “nonprofit” material participation**

The 8823 Guide notes that Treasury Regulation §1.469-5T provides rules for determining the material participation for “individuals.” IRC §469(h)(4) and Treas. Reg. §1.469-5T(g)(3) provide rules for determining

the material participation of certain corporations. However, the Guide cautions that, “because neither of these provisions applies to nonprofit organizations, they should be reviewed for illustrative purposes.” So, the treasury regulations are not necessarily bright line rules, but indicators that would seem to require additional inquiry into the nonprofit’s role.

Treas. Reg. §1.469-5T(a), which applies to individuals for purposes of Section 469 states that an “individual” would be viewed as materially participating in an activity for the taxable year if and only if the individual:

- Participates in the activity for more than 500 hours during such year;
  - Participation in the activity for the year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interest in the activity) for such year;
  - Participation in the activity is for more than 100 hours during such year and this participation is not less than any other owner;
  - Participation in multiple projects and the aggregate participation in all significant participation activities during such year exceeds 500 hours;
  - Materially participated in the activity during the ten taxable years that immediately precede the taxable year;
6. The activity is a personal service activity (health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting) and the individual materially participated in the activity for any three taxable years; or
  7. Based on all of the facts and circumstances (taking into account the rules in paragraph b of this section), the individual participates in the activity in a regular, continuous and substantial basis during such year.
    - a. Paragraph (b) states: an individual’s services performed in the management of an activity shall not be taken into account in determining whether such individual is treated as materially participating, unless no person other than the individual who performs management activity receives compensation described in section 911(d)(2)(A) in consideration for such services; and no individual performs more hours of service than the individual performing management activities.(reiterates#3 above). Also participating 100 hours or less shall not be treated as materially participating in such activity.

Except as provided in the treasury regulations, no interest in a limited partnership as a limited partner shall be treated as an interest with respect to which a taxpayer materially participates. And a partnership interest shall be treated as a limited partner interest if the interest is designated as a limited partner But, if the nonprofit in question has both a limited partner and a general partner interest, then the nonprofit would not be viewed as being a limited partner. In other words, the focus would shift to the general partner interest. Again, in order to be viewed as materially participating the individual would need to be involved in day-to-day operations of management. MHDC would look to the scope of the nonprofit’s role as general partner (or member in the case of an LLC) by reviewing the limited partnership agreement or equivalent to see if only minimal control is given to the nonprofit.

### **B. 8823 Guide Examples**

The 8823 Guide also emphasizes that the nonprofit entity must be materially participating in the operation and control of the project, i.e., both management decision-making and day-to-day operations. Examples from the 8823 Guide when a nonprofit is viewed as having management involvement are:

- The nonprofit, as a co-general partner, was on site during inspection, received report and corrected a noncompliance issue.
- The qualified nonprofit that owns a project could also show management involvement by hiring a third party management company that reports to and is paid by nonprofit management organization.

Examples from the 8823 Guide of when a nonprofit is not materially participating are:

- The qualified nonprofit is a co-general partner but has not participated directly or through representative in any monthly management meetings in year 3 of compliance period and does not otherwise participate on a regular, continuous, or substantial basis.
- Nonprofit is co-general partner and the third party management company reports to the for-profit co-general partner. The management company employs a property manager who signed an agreement to be a volunteer for nonprofit. Out of compliance because the property manager's volunteer role is really employee role for the for-profit.

## **Conclusion**

Material participation is only present if the nonprofit is “involved in the operations of the activity on a basis which is regular, continuous, and substantial.” Taking into account Sections 42 and 469 of the IRC, the 8823 Guide and treasury regulations, as well as input from the IRS LIHTC Program, the following indicators or factors should be assessed on a case-by-case basis when determining the status of the nonprofit in question.

### Material Participation may be present if Nonprofit:

1. Has a general partner (GP) or co-GP interest, or managing member interest in LLC;
2. Is involved in day-to-day activities, or on a regular, not sporadic basis;
3. Involved in regular activities throughout the year; and
4. Is onsite regularly; and/or
5. Hires third party management but pays the management company and management company reports
6. to nonprofit, involving the nonprofit in regular decision making
7. Is involved more than 500 hours a year; or
8. Is involved more than 100 hours a year and this participation is not less than any other owner.

### Material Participation is not likely to be present or not present if Nonprofit:

1. Only has a limited partner role or investor member role;
2. Participates only sporadically;
3. Only passively consents to decisions by the management;
4. Is involved less than 100 hours a year;
5. Is not onsite regularly; or
6. Third party management is supervised by for-profit entity.