

STATEMENT BY REP. NANCY L. JOHNSON OF CONNECTICUT ON THE INTRODUCTION OF LEGISLATION TO CLARIFY THE ELIGIBILITY OF CERTAIN EXPENSES FOR THE LOW-INCOME HOUSING TAX CREDIT

NOVEMBER 15, 2001

Mr. Speaker, I am introducing legislation to clarify the standards for determining basis of property for purposes of calculating the amount of low-income housing tax credits for which that property may be eligible. I am proud to be joined in this effort by Rep. Charles Rangel, Rep. Gary Miller,

A year ago, I called my colleagues' attention to the fact that the Internal Revenue Service, in a series of technical advice memoranda, had taken a very restrictive view of what items were includible in basis for purposes of allocating low-income housing tax credits. At that time, I noted that this would have an adverse impact on the ability of states to target affordable housing to those who need it the most.

It was also troubling to me that after 16 years during which the Treasury Department had failed to issue regulations or provide any other guidance on this issue, the first pronouncement was in a series of technical advice memoranda. TAMs are not official guidance, reviewed by the Treasury Department, but merely IRS legal opinions provided to an IRS agent during an audit. They are not citable in court proceedings because they are not official guidance. However, in absence of official guidance, I feared that these TAMs would be taken as an official government position. In fact, that is exactly what has happened, as investors in tax credit properties have required that any properties in which they invest must meet the standards set forth in the TAMs.

It is important to note that the Treasury Department agreed that this was an issue worthy of review and placed it on this year's Treasury Department/Internal Revenue Service business plan. I understand that there may be some guidance in the pipeline on one of the items addressed by the TAMs, but there does not seem to be much progress on a full review of the impact of the positions taken in the TAMs on the policy goals of the low-income housing tax credit program.

It is important to understand that this legislation will not increase the number of low-income housing tax credits available. The maximum amount of credits that the states may allocate to developers of affordable housing properties is set by the Internal Revenue Code. Thanks to legislation that we enacted last year, that amount available to each state will increase next year to \$1.75 times the state's population. That is a hard cap on the revenue impact. Since the unmet demand for affordable housing is many times greater than what can be built with the help of the credit, our legislation should not affect revenues. In fact, the only way for this legislation to have a revenue impact is if the legislation makes it easier for the states to use the credits we intend for them to have under present law.

What this legislation does, however, is very important. To understand its importance, it may be useful to have a little background on how the low-income housing tax credit works. In economic terms, the credit is equity financing which replaces a portion of debt that would

otherwise be necessary to finance a property. By replacing debt, credits work to reduce interest costs. This allows a property to be rented at lower rates than otherwise would be the case.

States allocate credits to individual properties based on criteria provided in the Internal Revenue Code and additional criteria they establish to provide affordable housing that closely matches the needs of the state's population. A state, thus, has a strong incentive not to allocate more credits to a property than necessary, because, if it did, it would have fewer credits to allocate to other properties.

In addition, the amount of credits a state may allocate to a particular property is limited by the Internal Revenue Code. The limit is determined as percentage of the basis of a property. The basis is, generally speaking, the costs of constructing a building that is part of an affordable housing project. The percentage is 9 percent for a new building that is not otherwise federally subsidized, and 4 percent for existing buildings and new buildings that receive other federal subsidies. Thus, the smaller the basis is, the fewer the credits that may be allocated.

The problem is that the TAMs take the position that certain construction costs should not be included in basis. The effect of this position is to make a large number of affordable housing properties financially infeasible and weaken the economics of those that still pass minimum underwriting requirements. The loss of equity would affect most severely properties that serve the lowest income tenants, provide higher levels of service or operate in high cost areas. The reason for this is simply that reducing the amount of credits does not reduce the development costs. It merely removes a source of financing, forcing either higher rents or lower quality construction.

In many cases the largest item that would be excluded from eligible basis under the TAMs are impact fees. These fees, covering a wide range of infrastructure improvements including, sewer lines, schools, roads, are imposed because of the "impact" of construction of the improvements on the land and would not be incurred if the land remained undeveloped. Certainly, whether or not they are includible in basis for the purpose of calculating the amount of tax credit, these costs will be incurred and will impact the economics of the property. This legislation will clarify that these costs are includible in eligible basis.

Other items that would be severely restricted or excluded from eligible basis under the interpretations expressed in the TAMs are site preparation costs, development fees, professional fees related to developing the property, and construction financing costs. The legislation we are introducing today will clarify that any cost incurred in preparing a site which is reasonably related to the development of a qualified low income housing property, any reasonable fee paid to the developer, any professional fee relating to an item includible in basis, and any cost of financing attributable to construction of the building is includible in basis for the purpose of calculating the maximum amount of credit a state may allocate to a low-income housing property.

The intent of these clarifications is simply to codify common industry practice before the issuance of the TAMs. Not only will the legislation allow the low-income tax credit program to

provide better quality housing at lower rental rates than would be possible if the positions taken in the TAMs are followed, but clarification will help simplify administration of the credit by giving both taxpayers and the Internal Revenue Service a clearer statement of the standards that apply in calculating credit amounts.

Our economy is not doing as well as we thought it was a year ago when I first spoke about this issue. We are going to need even more affordable housing than we thought last year. We should be proud that we increased the amount of low-income housing tax credits that will be available to help finance this housing. What we need to do now is to make sure that these credits are used as efficiently as possible to provide housing for those who need it the most. The legislation we are introducing today will help achieve that goal.