

By Mr. GRAHAM (for himself, Mr. **HATCH**, Mr. **JEFFORDS**, Mr. **KERRY**, and Mr. **TORRICELLI**):

S. 2006. A bill to amend the Internal Revenue Code of 1986 to clarify the eligibility of certain expenses for the low-income housing credit; to the Committee on Finance.

Mr. GRAHAM. Madam President, today I am introducing legislation that will improve the effectiveness of one of the most effective programs we have to help Americans get affordable housing, the Low Income Housing Tax Credit. I am proud to be joined in this effort by my esteemed colleagues Senator *Hatch*, Senator *Jeffords*, Senator *Kerry* and Senator *Torricelli*.

The Low Income Housing Tax Credit was created in 1986 to attract private sector capital to the affordable housing market. It has been the major engine for financing the production of low income multi-family housing. The program offers developers and investors in affordable housing credit against their Federal income tax in return for their investment. Since its inception, the Low Income Housing Tax Credit has assisted in the development and availability of roughly 850,000 new and rehabilitated units of affordable housing.

Last fall, the Internal Revenue Service issued its first guidance in the program's 16 year history. That guidance was issued in the form of several technical advice memoranda, or TAMs, and specified which development costs will be eligible and ineligible for the credit, known as eligible basis.

TAMs are not official guidance, reviewed by the Treasury Department, but instead, IRS legal opinion providing direction to IRS agents conducting audits. They are not citable in court proceedings because they are not official guidance. In the absence of official guidance, TAMs could be taken as the official government position. In fact, that is exactly what is happening. The IRS's position is contrary to common industry practice, and eliminates many reasonable, legitimate and necessary costs from the tax credit. This has caused uncertainty among investors as to whether the credits for which they have been paid, will be realized. Moreover, these guidelines could adversely affect the ability of States to target affordable housing to those who need it the most.

It is important to understand, this legislation will not increase the number of low-income housing tax credits available. The maximum amount of credits that states may allocate to developers of affordable housing properties is set by the Internal Revenue Code. Thanks to legislation that we enacted in 2000, the amount available to each state has increased from \$1.50 to \$1.75 times the State's population.

That 40 percent increase is expected to produce about 30,000 more units a year. 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 do, 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 owner to offer lower rents than otherwise would be the case.

The most unique feature of the program is that State Housing Finance Agencies award Federal tax credits to developers of rental housing. Since these agencies have considerable flexibility in how they distribute the credits, developers compete for the limited number of tax credits by

submitting project proposals. The Housing Finance Agencies rate the proposals, and allocate credits to individual properties based on criteria provided in the Internal Revenue Code, and on the State's particular housing needs and priorities.

The amount of credits a State may allocate to a particular property is also 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. Non-federally subsidized new construction may receive a 9-percent credit. Existing buildings and new buildings receiving other Federal subsidies may get a 4-percent credit.

The problem at hand is this. The IRS takes the position that certain construction costs should not be included in basis. This position makes a large number of affordable housing properties financially infeasible, and weakens the economics of those that still pass minimum underwriting requirements. The loss of equity would surely affect the properties that serve the lowest income tenants, provide higher levels of service, or operate in high cost areas. The reason that this is problematic is simple. 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.

Apparently, the Treasury Department and Internal Revenue Service agree that this is an issue worthy of review, as both agencies have included it in their business plan. As recently as this month, the IRS issued new guidance on one of the items addressed by the TAMs, but there does not appear to be a full review of the effect of the positions set forth in the TAMs anytime soon.

This legislation would amend Section 42(d) of the Internal Revenue Code to specify that various associated development costs are to be included in eligible basis. In many cases, the largest item excluded from eligible basis under the TAMs is "impact fees." Impact fees are fees required by the Government "as a condition to the development" and considered ineligible because they are one-time costs, unlike building permits which need to be renewed each time a building is built. These fees cover a wide range of infrastructure improvements including sewer lines, schools, and roads. 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. As I mentioned previously, the IRS has recently addressed the inclusion of impact fees in eligible basis, but not other costs directly related to building construction.

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 would like, and there is a significant likelihood that we are going to need even more affordable housing in the not too distant future. 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.

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Mr. JEFFORDS. Mr. President, today I join with my colleagues on the Finance Committee, Senators **GRAHAM** and **HATCH**, to introduce legislation to clarify the rules governing the low-income housing tax credit. This tax credit has played a critical role in the construction and renovation of housing for low-income Americans.

The Internal Revenue Service has issued five technical advice memoranda, TAMs, affecting the definition of eligible basis as defined in section 42(d) of the Internal Revenue Code. These TAMs had the effect of reducing the amount of tax credits available with respect to projects financed with low-income housing tax credits. The bill we introduce today recognizes that certain expenses are legitimate development costs that are properly includible in the basis eligible for the tax credits. Among these development costs are: state and local impact fees, site preparation costs, reasonable development fees, professional fees, and construction financing costs, excluding land acquisition costs.

The TAMs drew unworkable distinctions among various costs developers incur when they build low-income housing. For example, under the law as interpreted by the IRS, a low-income housing developer would have to distinguish between those trees and shrubs planted near a housing unit and those planted elsewhere on the property. The costs of trees and shrub near the housing unit could be included in basis; the costs of other landscaping could not. Rules like this are not only illogical; they also impose unnecessary burdens both on developers of affordable housing projects, but also on the IRS itself, whose employees must draw these highly technical distinctions when they audit the project. Our bill includes fair and rational rules, introducing the concept of "development cost basis" in lieu of "adjusted basis" to determine which costs may qualify for tax credits. It assures that reasonable and legitimate expenses which incurred only for the purpose of building low-income housing will be eligible for tax credit.