

Transitioning to the Flat 9% Credit Percentage: How Locked-in is Locked-in?

By Gary P. Downs, Pillsbury Winthrop Shaw Pittman LLC

The recently adopted Housing and Economic Recovery Act of 2008 (Act) fundamentally changes the federal Low-Income Housing Tax Credit (LIHTC) program. Unfortunately for certain projects currently in development or being sold, Congress did not spell out how to transition to the new rules. Prior to the new law, tax credit percentages were adjusted monthly under a formula based on the Applicable Federal Rate. Under the new Act, for newly constructed, non-federally subsidized buildings placed in service after the date of enactment and before December 31, 2013, the 70 percent present value credit percentage has a minimum annual percentage of 9 percent. No change was made to the 30 percent present value credit (also known as the 4 percent credit). Typically, a 9 percent new construction project would elect to use the credit percentage published at the time of the carry-over allocation package submittal. For the last few years, the fluctuating rate has been in the low 8 percent range, so increasing the percentage to the flat 9 percent will increase credits by 10 percent or more. The problem is that the election to lock in a credit percentage is irrevocable under the Internal Revenue Code (IRC), and it is unclear whether locked-in projects that will be placed in service after the effective date of the new Act can take advantage of the new rate floor. Such projects appear to be caught in the middle between the old law and the new Act and need clarification from the Internal Revenue Service (IRS).

The Threshold Issue

In almost all states, the state housing credit agency awards 9 percent allocation under a competitive system. The credit percentage increase will therefore aid only those projects that have more awarded allocation than they could use or that are in states that are willing to allocate additional credits. The new law does increase the state housing credit

ceiling from \$2 per resident to \$2.20 per resident. In the few "caught-in-the-middle" projects in which we have been involved, additional allocation appears to be available from the state.

The Irrevocable Election

The election to fix a credit percentage under the old law is irrevocable (although one can petition the IRS for relief under the general procedures regarding tax elections). However, the language used in the new law does appear to fix a minimum credit percentage without any exception for deals where an election to lock is already in place. It is likely that the IRS will interpret the new language as intending to provide relief and, accordingly, will develop a procedure to allow taxpayers to request supplemental allocations and revoke previous elections to lock in. Based on conversations with the IRS, however, due to procedural requirements guidance many not be forthcoming from the IRS anytime soon. Without direction from the IRS, tax practitioners appear unlikely to opine that the 9 percent flat rate can be used because the election is technically irrevocable.

The Continued Importance of the Rate Lock Election

The rate lock mechanism is still relevant for three reasons. First, interest rates could spike upward, causing the applicable percentage to go higher than 9 percent. In that case, the taxpayer will want to lock in during the spike. Second, rate locking for acquisition rehabilitation transactions is important. Acquisition basis only receives the 4 percent credit, which was not given a floor under the new legislation. The taxpayer still must elect to lock in the credit percentage related to acquisition basis. Lastly, the new Act's floor is only temporary and expires December

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31, 2013. If the project will be placed in service after that date, the taxpayer is back to having to make the election for all project basis.

The Call to Action

Developers with caught-in-the-middle projects should lobby the IRS for guidance. If guidance is not forthcoming quickly, developers have the right to apply for a private letter ruling. In fact in one conversation with the IRS, the IRS suggested that this issue is ripe for a private letter ruling request. Although the industry technically cannot

rely directly on a private letter ruling, it often does use such rulings to settle this type of uncertainty. We look forward to a speedy resolution of this transition issue. ❖

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