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Tax Reform Panel Considers Proposals that Could Affect the LIHTC

By Michael J. Novogradac, CPA

The Bush Administration's announcement that tax reform would be one of its top priorities in the president's second term took shape early this year with the January 7 creation of the President's Advisory Panel on Federal Tax Reform, headed by former Sens. Connie Mack and John Breaux.

Even earlier, the foundation for tax reform was being laid. In November during a post-election press conference, the president's remarks on tax reform had analysts speculating on the possibility of everything from eliminating the mortgage interest deduction to abolishing the current system in favor of a flat tax, a value-added tax or a national sales tax. These conjectures also raised fears that the low-income housing tax credit (LIHTC) program, which was created by the Tax Reform Act of 1986 as an alternate method of funding housing for low- and moderate-income households, could be in jeopardy.

And indeed, in February, the United States Government Accountability Office (GAO) released its report on "21st Century Challenges: Reexamining the Base of the Federal Government." The report points to the extensive use of tax incentives to promote social and economic objectives as a part of the growing complexity of the tax system. That system, according to the GAO, includes "hundreds of billions of dollars of such incentives — the same magnitude as total discretionary spending." The report specifically points to the LIHTC as the federal government's largest program for creating new affordable housing units and the earned income credit as its largest cash assistance program for low-income families. Moreover, the report notes, tax incentives do not compete in the annual budget process and effectively are "fully funded" before any discretionary spending is considered. "Further, relatively little is known about the effectiveness of tax incentives in achieving the objectives intended by the Congress. As far back as 1994, GAO concluded these incentives deserved more scrutiny."

The GAO says that the intent of its report is to help Congress in reviewing and reconsidering the base of federal spending and tax programs.

Others were speculating on the effect any reform would have on tax-exempt bonds. An article in the November 11, 2004 *The Bond Buyer* notes that an overhaul of the tax code could increase the borrowing costs for bond issuers, thereby increasing borrowing costs to make up for the loss of tax incentives and reducing funding for capital projects.

Industry Response

In December, the National Association of Home Builders (NAHB) released a statement, noting that it already was working closely with the White House and Capitol Hill leaders to ensure that the interests of the entire housing community would be well-served as tax reforms move forward. "NAHB's policy is not only to protect the LIHTC, but to enhance it, and that will be a primary focus for our advocacy staff," the organization said in a prepared statement. The National Apartment Association/National Multi Housing Council (NAA/NMHC) also indicated it would follow the work of the advisory panel to ensure that "the interests of the multifamily industry are well-served" during the tax reform discussions and also vowed to work closely with other real estate organizations to "present a common front to the maximum extent possible."

Tax Reform Panel Meetings

In announcing the witness list for the panel's first meeting on February 16 in Washington, D.C., Breaux said, "The current tax system is an unfair burden on Americans .... This is a unique opportunity to work in a bipartisan effort and find ways to make the tax system serve Americans better." Witnesses at the February 16 meeting provided a history of the current tax system and explained the differences between a tax on income and a tax on consumption.

In its February 22, 2005 *Daily Tax Report*, BNA Tax Core noted that while the Administration has not taken a position on any particular tax reform proposal, there appears to be a predilection for a consumption based tax. In its reporting, the *Daily Tax Report* noted that a consumption tax was a significant part of a chapter on tax reforms in Bush's February 17 economic report to Congress and that outgoing Council of Economic Advisers Chairman Greg Mankiw had

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emphasized that a consumption-based tax system is seen by many economists as more efficient than an income tax – a view that is seemingly held by Fed Chairman Alan Greenspan, albeit with a caveat.

Greenspan, chairman of the Board of Governors of the Federal Reserve System, told the tax reform panel members in remarks on March 3 that, "many economists believe that a consumption tax would be best from the perspective of promoting economic growth – particularly if one were designing a tax system from scratch – because a consumption tax is likely to encourage saving and capital formation. However, getting from the current tax system to a consumption tax raises a challenging set of transition issues". The March 3 meeting, held in Washington, D.C., focused on additional perspectives on tax reform, as well as a description of the problems presented by the complexity in the tax system, including the alternative minimum tax (AMT). The reform of the vexatious AMT is expected to be a chief focus of the final recommendations

Greenspan called for creating a tax code that would reduce the resources devoted to complying with current tax laws and using the freed-up resources for more productive purposes. "A principle I believe is important now … is predictability in the tax code," he said. "Creating a tax system in which households and businesses can look into the future and have some reasonable degree of certainty about the future tax implications of decisions made today."

At the March 16 meeting of the panel at the University of Chicago's Gleacher Center, Chicago mayor Richard M. Daley urged the panel to recommend changes in the federal tax code that would help benefit working families and rebuild cities, asking members to look for ways to use the tax code to spur the creation of affordable housing and encourage the rebuilding of urban infrastructure.

Conclusion

In the months ahead, the affordable housing industry must keep its eye on any tax reform proposals and consider the possible effects such proposals will have on the industry.

The tax reform advisory committee's recommendations are expected to be submitted by late July, presumably so that the Treasury can submit a formal legislative proposal to Congress in the fall. This will no doubt be followed by months of congressional hearings and a possible legislative proposal in 2006. For a list of advisory committee members and witnesses, and other information visit the panel's official web site at www.taxreformpanel.gov. ❖