September 12, 2002

The Honorable Pamela F. Olson
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Ave., N. W.
Washington, D.C. 20220

Dear Assistant Secretary Olson:

As members of Congress who strongly support the low-income housing tax credit program, we are writing to express concern over a recent memorandum ruling concerning the treatment of casualty losses under Section 42(j)(4)(E) of the Internal Revenue Code of 1986. Memorandum 200134006 was issued by the Office of Associate Chief Counsel (Passthroughs and Special Industries). We believe that this memorandum is inconsistent with prior Internal Revenue Service rulings and informal advice, with congressional intent in enacting Section 42, and that it establishes bad public policy.

That ruling held 1) that the term "casualty loss" should have the same meaning as set forth in generally accepted tax principles and that a period of up to two years after the casualty to restore the property is acceptable; 2) that state housing credit agencies should report to the Internal Revenue Service, as noncompliance with Section 42, any casualty loss that takes low-income property out of service and results in a reduction of qualified basis and 3) that property owners may not continue to claim low-income housing credits during the period that units are not in service because of a casualty event, although no recapture of previously claimed credits is required provided that the property is restored in a timely manner. We concur with the first holding and with the conclusion that no recapture of prior credits is required if the owner restores the property within the time frame provided.

However, we take strong issue with the rulings that the occurrence of a casualty requires reporting of noncompliance and that owners lose credits during the period in which the units are out of service; indeed, under the ruling, such credits are lost forever. We note, as did the ruling, that the Service had previously advised the state housing credit agencies on an informal basis that they did not need to report noncompliance in the event of a casualty and that owners could continue to claim credits while the property was being restored. Not only was that advice, in our view, correct, but the entire industry, including agencies, owners and investors, had relied upon it. To change position at this point is fundamentally unfair. We are concerned that because of this new risk, investors will be less willing to invest in housing credit properties or that they will exact a "risk premium" and reduce what they pay for credits, thereby diminishing the program's efficiency in raising capital for investment in this housing.

In addition, the informal advice previously provided is consistent with Revenue Procedure 95-28, in which the Service provided relief for projects in areas affected by a major disaster, as declared by the President. In Section 7.01 of Rev. Proc. 95-28, the Service stated that owners of projects in such areas are not subject to a loss of credits and that agencies need not report noncompliance, provided that the project's qualified basis was restored within a reasonable period (24 months after the end of the year in which the disaster area declaration occurred).

We believe that the relief provided by the above-cited Revenue Procedure to be fair and consistent with the purposes of Section 42. However, we see absolutely no justification for a different set of rules depending on whether the casualty is caused by a major disaster or by a "regular" casualty, such as a localized fire or thunderstorm. For a particular property owner, the results of the two events are the same: some or all of the property must be taken out of service because of an event over which the owner has no control. It makes no difference whether the casualty is widespread or localized. What possible public policy is advanced by such a distinction?

It is true that Section 42(j)(4)(F) only specifically addresses the avoidance of recapture of previously claimed credits in the event of a casualty, where the property is restored within a reasonable period of time. However, we believe the ruling interprets the statute too narrowly. In our view, Congress intended that owners not be penalized because of casualty events either with respect to prior credits or with respect to credits to be claimed during the restoration period. Our belief is supported by language contained in the Conference Report accompanying the Tax Reform Act of 1986 (Rpt. 99-841), which states (at page II-94) that:

Vacant units, formerly occupied by low-income individuals, may continue to be treated as occupied by a qualified low-income individual for purposes of the set-aside requirement (as well as for determining qualified basis) provided reasonable attempts are made to rent the unit and no other units of comparable or smaller size in the project are rented to nonqualifying individuals.

Units damaged by a casualty and which must be taken out of service are "vacant;" owners go through the process of restoration in order to rent the unit following completion of the work. Although this language is also applied to situations where a unit is vacant, but still in service, while it is marketed for occupancy, there is no reason not to apply it where the reason for the vacancy is a casualty, as opposed to market conditions. <u>In short, Congress did not intend to punish owners when their units are vacant, regardless of the reason, as long as owners are making reasonable attempts to do whatever is necessary to have the units occupied, whether those attempts involved restoration or marketing</u>.

We hope you will take the necessary steps to reverse this memorandum ruling and that the Service will issue a new ruling, consistent with Rev. Proc. 95-28, which holds that agencies are not required to report noncompliance in the event of a casualty and that owners may continue to claim credits during the restoration period, provided that the property's qualified basis is restored within a 24 month period.

Should you wish to discuss this matter, please contact, Todd Funk with Rep. Johnson or Jon Sheiner with Rep. Rangel. Thank you for your consideration.

Sincerely,

Nancy L. Johnson

Charles B. Rangel

Member of Congress

Member of Congress