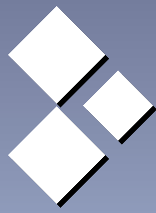
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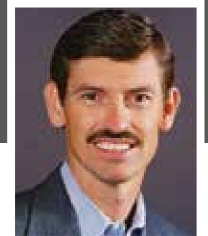

Small Ways to Make a Big Difference

MICHAEL J. NOVOGRADAC, CPA

The seemingly endless discussion of tax reform in Congress continued last month as Senate Finance Committee Chairman Orrin Hatch, R-Utah, and Ranking Member Ron Wyden, D-Ore., accepted public comment by way of the five tax reform working groups they formed in January. Each group–individual income tax, business income tax, savings and investment, international tax, and community development and infrastructure–has been examining different components of the tax code and they are slated to produce a report this month.

The community development and infrastructure group is of extremely high interest to the affordable housing, community development and historic preservation communities, as it has jurisdiction over the low-income housing tax credit (LIHTC), new markets tax credit (NMTC) and historic tax credit (HTC). Led by Sen. Dean Heller, R-Nev., and Sen. Michael Bennet, D-Colo., the group also includes Sens. Dan Coats, R-Ind.; Tim Scott, R-S.C.; Maria Cantwell, D-Wash.; and Bill Nelson, D-Fla. In addition, the business income tax reform working group is particularly relevant as its purview includes examining renewable energy tax credits (RETCs), corporate tax rates and depreciation, including depreciation lives and methods for residential rental real estate. That working group is led by Sen. John Thune, R-S.D., and Sen. Ben Cardin, D-Md., and includes Sens. Pat Roberts, R-Kan.; Richard Burr, R-N.C.; Johnny Isakson, R-Ga.; Rob Portman, R-Ohio; Pat Toomey, R-Pa.; Coats; Debbie Stabenow, D-Mich.; Tom Carper, D-Del.; Bob Casey, D-Pa.; Mark Warner, D-Va.; Robert Menendez, D-N.J.; and Nelson.

Each working group has been discussing the pros and cons of the current code, considering tax reform scoring issues, and examining interaction between code sections and how they would be affected by tax reform. Public comment was accepted through April 15. The Novogradac LIHTC Working Group and NMTC Working Group submitted comment letters in support of retaining and strengthening the LIHTC and NMTC, respectively.

In addition to deciding whether tax provisions should remain in the code, each working group is examining how provisions that they decide to retain can be made more effective. In the spirit of taking the opportunity presented by tax reform as a chance to perfect these beneficial tools, the comment period is a crucial step in the tax reform process. The tax credit community stands in the ideal position to share with lawmakers how years of innovation and market efficiency can be refined to be even more successful.

For instance, the LIHTC's long and sterling track record doesn't mean it can't be enhanced and improved. The following are some examples of ways the tax code could be honed to expand the usefulness of the LIHTC.

continued on page 2

continued from page 1

Proposals for Improving the LIHTC

Eliminate 10 percent test (but keep placed-in-service deadline)
In order to qualify for a carryover allocation, a developer must incur 10 percent of the reasonably expected qualified basis 12 months after receiving the award and place the property in service by the end of the following year. In practice, most developers are able to meet this test. However, in some circumstances, developers are forced to spend money just to qualify for the carryover allocation that doesn't really advance the development process in a meaningful way. Requiring the test adds unnecessarily to compliance costs for developers and allocating agencies. Making this revision would make the process more cost- and time-efficient. State allocating agencies would retain the right to establish readiness criteria to ensure the timely construction and placement in service of tax credit properties.

Qualify "over-income" tenants in preservation transactions if they were income-qualified at move-in
Under current law, when a property is recapitalized, the recapitalized property is considered a "new building" for tax purposes. However, a tenant who lives in such a property often still thinks of such a property as their home. Under this proposal, tenants in existing buildings whose incomes have risen over time to more than 60 percent of area median income (AMI) could be counted as at or below 60 percent for LIHTC income qualification purposes as long as they were income-qualified at move-in. That would make the financing of affordable housing preservation more feasible. It would also help facilitate the development of more mixed-income properties.

Repeal QCT basis boost population cap
Under current law, a 130 percent basis boost is available for properties in qualified census tracts (QCTs) designated by the U.S. Department of Housing and Urban Development (HUD) with poverty rates at or above 25 percent or where 50 percent or more of the households in the census tract have median incomes at or below 60 percent of the AMI. This QCT designation, however, is subject to a cap if the aggregate population of the census tracts exceeds 20 percent of the metropolitan area population. This proposal would remove the aggregate population cap, enabling properties in more areas within the metropolitan region to receive the 130 percent basis boost. This would likely make more Rental Assistance Demonstration (RAD) and other preservation projects financially feasible because they would qualify for the boost.

Narrow student rule
In general, the LIHTC cannot be used to finance student housing, even if students technically qualify for income purposes. In recent history, Congress enacted limited exceptions to this rule, such as enabling single parents and youth aging out of foster care to access LIHTC housing. Bills have been introduced to narrow the student rule further to allow veterans and homeless youth to live in LIHTC housing. Instead of enacting limited exceptions addressing specific populations, this proposal would narrow the application of the student rule just to the population as originally intended, simplifying program administration.

Revise definition of "federally subsidized" under section 42(b)
This proposal would modify the language on determining whether a building is federally subsidized to address uncertainty that arises when developments use 9 percent LIHTCs for a portion of the building and bond financing for another portion. Current law provides that a building will be considered federally subsidized if bond financing is used "directly or indirectly" with respect to such building. This proposal would revise the law to provide greater specificity as to what this means. This specificity would reduce unnecessary costs of development that can occur as a developer seeks to avoid indirectly tainting the 9 percent deal with bond financing.

Revise scattered site rule
Under current law, each building in scattered-site LIHTC properties must be 100 percent low-income, because of concerns that all low-income units would be placed in the least desirable building of the least desirable site of the property. However, this 100 percent low-income requirement makes some scattered-site developments financially infeasible, and complicates resyndications where existing tenants may be over-income. This proposal would modify the scattered site rule to allow buildings in such developments to be qualified as long as the units were proportionally distributed. For example, if a scattered-site property had a total of 50 units in five 10-unit buildings, each building could be qualified as long as each property had at least four low-income units (for a total of 20).

continued on page 3

continued from page 2

Allow qualified income for rural bond projects to be based on the greater of AMI or national nonmetro income

Under the Housing and Economic Recovery Act of 2008 (HERA), 9 percent LIHTC properties are allowed to use the greater of AMI or national non-metro income. This proposal would extend that LIHTC income qualification standard for bond-financed developments, which would be helpful in rural areas where AMIs are unusually low.

Next Steps

At the time of this writing, it is believed that the working groups' deliberations and the public comments submitted by April 15 will be used during the development of the comprehensive, bipartisan report that is expected by the end of May. This report may include a series of bipartisan reform proposals, which could be included in tax reform legislation Chairman Hatch drafts.

It remains to be seen how the process in the Senate will square with efforts in the House. House Ways and Means Committee Chairman Paul Ryan, R-Wis., has reported that his committee has been working behind the scenes with the Senate Finance Committee to "harmonize" their efforts and try to reduce demands on the Joint Committee on Taxation. Ryan and Hatch are said to meet weekly.

Given the limited time window for tax reform consideration before the 2016 presidential election begins to make bipartisan cooperation on high-profile legislation very difficult, Ryan and Hatch would need to begin consideration of their tax reform bills no later than the fall to have any significant chance of being enacted. As hours become days, days become weeks and weeks become months, the possibility of comprehensive tax reform before the next presidential election is certainly waning. As the possibility of comprehensive tax reform wanes, we will be watching for action on other tax bills, such as funding the highway trust fund–which faces a May 31 deadline–and tax extenders. ❖

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