September 11, 2008

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IRS Office of Chief Counsel
1111 Constitution Ave. NW
Room 5111
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The Honorable Eric Solomon
Department of the Treasury
Assistant Secretary (Tax Policy)
Room 3120 MT
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: Request for Guidance under the Housing and Economic Recovery Act of 2008[1] as commented upon by The Joint Committee on Taxation[2]

Dear Gentlemen:

As you know, the Housing and Economic Recovery Act of 2008 (the "Housing Act") has made sweeping changes to the low-income housing credit under §42 of the Internal Revenue Code of 1986, as amended. Many of these changes are already in effect for buildings placed in service after July 30, 2008, the effective date for many of the provisions contained in the Housing Act. The undersigned have come together to request guidance on several of these new provisions to insure compliance under the low-income housing program. We hope that the guidance we request below will be issued on an expedited basis in order that the important changes to the program contained in this legislation, which are critical to its continued success, can be implemented immediately. We have summarized the issues as follows:

- ***Housing Act Sec. 3002(a)(2) of the Housing Act–Determination of Credit Rate***

This provision provides that in the case of any new building which is placed in service by the taxpayer after July 30, 2008 and before December 31, 2013, and which is not federally subsidized for the taxable year, the applicable percentage shall be not less than 9 percent.

[1]The Housing Assistance Tax Act of 2008 is contained the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289 (2008).

[2] Joint Committee on Taxation, Technical Explanation of Division C of H.R. 3221, the "The Housing Assistance Tax Act of 2008" as Scheduled for Consideration by the House of Representatives on July 23, 2008, (JCX-63-08), July 23, 2008.

We would like clarification that owners that elected on or before July 30, 2008 to lock in an applicable percentage under §42(b)(2)(ii) are allowed to go back to the agency to seek more credit up to the amount which would result from the application of the 9 percent applicable percentage rate for qualified low-income buildings placed in service after July 30, 2008 and before December 31, 2013. We believe the statutory language, which states that the applicable percentage ***shall be not less than 9 percent***, is clear and overrides any applicable percentage rate elected under §42(b)(2)(ii).

While the Housing Act was not explicit on this point, we believe that congressional intent was to provide an immediate stimulus for owners of housing credit properties where the owner is able to demonstrate a need for additional housing credit to make a property financially feasible. One such tool was the application of the 9 percent credit. Our belief in this regard is bolstered by the fact that the provision is temporary—it applies only to properties placed in service after enactment and before December 31, 2013. Thus, for these properties and only these properties, the rate is not less than 9 percent.

However, we understand that several state housing credit agencies have taken the position that unless the Internal Revenue Service provides guidance on this matter, they will continue to regard the prior lock-in election as binding. While we believe that this interpretation is incorrect for the reasons mentioned above, we are concerned that this position may prevail in a number of states and that the congressionally desired immediate impact of this provision will be drastically lessened. Accordingly, we would ask that the guidance on this issue be expedited so as to correct this misinterpretation as soon as possible.

- ***Housing Act Sec. 3003(a)-- Modifications to the Definition of Eligible Basis***

The Housing Act provides that any building which is designated by the State housing credit agency as requiring the increase in credit under §42(d)(5)(C) (relating to buildings in high cost areas) in order for such building to be financially feasible as part of a qualified low-income housing project shall be treated as located in a difficult development area. This provision is effective for buildings placed in service after July 30, 2008.

The language of Section 3003(a) does not prescribe the manner by which the housing credit agencies are to implement this designation for increased credit allocations. However, we note that the explanation prepared by the Joint Committee on Taxation states at p.6 that it is expected that the State allocating agency shall set standards for determining which areas shall be designated difficult development areas and which projects shall be allocated additional credits in such areas in the State's qualified allocation plan and publicly express its reasons for such area designations and the basis for allocating additional credits to a project. Presumably this means that the States are expected to amend their qualified allocation plans to reflect these designations. Because of the time involved in modifying such plans, along with the requisite public hearing requirements, we recommend that the IRS and Treasury provide a reasonable transition period during which agencies may immediately implement this provision and begin to designate buildings as being treated in difficult to develop areas under the authority of §42(m)(1)(A)(iv). We believe a reasonable transition period would cover allocations made pursuant to qualified allocation plans issued with respect to 2008 (which already are in existence) and for 2009 (many

of which have already been drafted or have been finalized). This provision allows States to provide a written explanation to the general public for any allocation of a housing credit dollar amount which is not made in accordance with established priorities and selection criteria of the housing credit agency. Similarly, the State would provide a written explanation to the general public of its designation criteria in advance of modifying its qualified allocation plan with respect to the designation for buildings to receive the additional housing credit. We recognize, of course, that state specific administrative procedures will continue to apply but we believe that guidance from the IRS on this point will give states the flexibility they need, within the confines of their state's procedures.

- ***Housing Act Sec. 3003 (d)-- Clarification of the Treatment of Federal Grants***

The Housing Act amends §42(d)(5(A) to provide that the eligible basis of a building shall not include any costs financed with the proceeds of a Federally-funded grant.

The Joint Committee explanation at p.8 states that Federally-funded grants received during the compliance period that enable property to be rented to low-income tenants, are not required to reduce eligible basis if those grants do not otherwise increase the taxpayer's eligible basis in the building.

The technical explanation also directs the modification of section 1.42-16(b) of the Income Tax Regulations to provide that none of the following shall be considered a grant made with respect to a building or its operation for purposes of section 42(d)(5)(A) of the Internal Revenue Code of 1986: (1) rental assistance under section 521 of the Housing Act of 1949 (42 U.S.C. 1490a); (2) assistance under section 538(f)(5) of the Housing Act of 1949 (42 U.S.C. 1490p-2(f)(5)); (3) interest reduction payments under section 236 of the National Housing Act (12 U.S.C. 1715z-1); (4) rental assistance under section 202 of the Housing Act of 1959 (12 U.S.C. 1701q); (5) rental assistance under section 811 of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 8013); (6) modernization, operating, and rental assistance pursuant to section 202 of the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4132); (7) assistance under title IV of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11361 et seq.); (8) tenant-based rental assistance under section 212 of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12742); (9) assistance under the AIDS Housing Opportunity Act (42 U.S.C. 12901 et seq.); (10) per diem payments under section 2012 of title 38, United States Code; (11) rent supplements under section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. 1701s); (12) assistance under section 542 of the Housing Act of 1949 (42 U.S.C. 1490r); and (13) any other ongoing payment used to enable the property to be rented to low-income tenants. Further, no basis reduction is required for loans (regardless of interest rate) made to owners of qualified low-income housing projects from the proceeds of Federally-funded grants.
Finally, the technical explanation concludes that:

> Nothing contained in the above direction to modify the regulations is intended to create any inference with respect to the consideration of any program specified under subsection (a) of any grant made with respect to a building or its operation for purposes of section

42(d)(5)(A) of the Internal Revenue Code of 1986 as in effect on the day before such date of enactment.

Although slightly ambiguous (given the reference to "subsection (a)" for which no reference exists), we believe the above language means that the programs identified in the technical explanation, and any other ongoing payment used to enable property to be rented to low-income tenants before the enactment of the Housing Act also are not grants made with respect to a building or its operation for purposes of section 42(d)(5)(A).

Under prior law, for the IRS to designate a program as not being a federal grant, required the publication of a revenue ruling in the Internal Revenue Bulletin under section 1.42-16(b)(3). We believe that on a practical level it would not make sense for the IRS to determine, with respect to ongoing payments made before the Act's effective date, whether funds from each of the above programs are grants since the Joint Committee has clarified that none of these programs shall be considered a grant made with respect to a building or its operation for purposes of section 42 (d)(5)(A). Accordingly, in light of this congressional intent, we ask that the IRS and Treasury announce that it will not treat such payments, made before the effective date of the Housing Act, as grants.

- ***Housing Act Sec. 3003(f)--Exception to the 10-Year Nonacquisition Period for Existing Buildings Applicable to Federally- or State-Assisted Buildings***

The new law exempts federally- or state-assisted buildings from the 10-year prior placement in service rule under §42(d)(2)(B)(ii). The term federally-assisted building means any building which is substantially assisted, financed or operated under section 8 of the United States Housing Act of 1937, section 221(d)(4), or 236 of the National Housing Act, Section 515 of the Housing Act of 1949 or any other housing program administered by the Department of Housing and Urban Development or by the Rural Housing Service of the Department of Agriculture. The term state-assisted building means any building which is substantially assisted, financed, or operated under any State law similar in purposes to any laws relating to the definition of federally-assisted building.

We would like clarification of what it means to be "substantially assisted, financed or operated." The term "substantially" is not defined in the Housing Act. We propose adopting a bright line test that would define a federally-assisted building as a building in which 20% or more of the building or units are assisted, financed or operated under section 8 of the United States Housing Act of 1937, section 221(d)(4), or 236 of the National Housing Act, Section 515 of the Housing Act of 1949 or any other housing program administered by the Department of Housing and Urban Development or by the Rural Housing Service of the Department of Agriculture. A similar definition would apply for State-assisted buildings in which 20% or more of the building or units are assisted, financed, or operated under any State law similar in purposes to any laws relating to the definition of federally-assisted building. The calculation would be based on (i) the number of units assisted as a percentage of the total number of dwelling units in a building, in the case of a rental subsidy program such as Section 8, or (ii) the amount of qualifying financing as a percentage of the acquisition price of the building paid by the buyer, in the case of debt financing such as Section 221(d)(4), or (iii) the number of units operated (i.e., regulated) as a

percentage of the total number of dwelling units in the building, in the case of any such program; in any event, the calculation would be made as of the date of acquisition of the building.

We chose a threshold of 20% or more because we believe it is a reasonable measure and in keeping with HUD's standard for defining "Partially-assisted Projects" for purposes of Section 8 of the United States Housing Act of 1937. See generally, 24 CFR sec. 880.201, 881.201, and 883.302 (2008). In addition, we point out that there are other provisions in Section 42 that utilize a 20% standard—(i) the so-called 20/50 test under which not less than 20% of a project's units be occupied by households whose incomes are not more than 50% of area median gross income and (ii) the new standard for measurement of a "substantial rehabilitation" requires rehabilitation expenditures of not less than 20% of adjusted basis.

- ***Act Sec. 3004(c)-- Repeal of Bond Posting Requirement***

The new law repeals the bond posting requirement under §42(j)(6) with respect to dispositions of interests in a building after July 30, 2008 and extends the otherwise applicable statute of limitations until three years after the Secretary of the Treasury is notified by the taxpayer of noncompliance with the low-income housing credit rules that may have occurred at any time during the remaining compliance period. The new law also applies to dispositions on or before July 30, 2008, if the taxpayer elects application of the new provisions. There is nothing in the statutory language which requires the Secretary to prescribe regulations on this point or forms to effectuate the making of this election. Accordingly, the election is self-executing and the number of taxpayers with outstanding bonds that elect to apply the Housing Act provisions is likely to be relatively small. Consequently, we recommend that the IRS and Treasury issue an announcement that taxpayers making this election need only notify the IRS in a written statement of its intent to elect to apply the Housing Act provisions to its outstanding bond, along with a copy of its approved Form 8693, Low-Income Housing Credit Disposition Bond. Such documentation would also be attached to its next Federal income tax filing. If a recapture event does occur, the taxpayer will notify the IRS of such recapture in writing to commence the three-year statute of limitations.

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We hope you will be able to provide clarification and guidance to the above issues in a timely manner consistent with the spirit of the new legislation to modernize and simplify the low-income housing credit program. We stand ready to work with the IRS and Treasury and would like to meet with you at your earliest convenience to more fully discuss these issues. Please contact Rick Goldstein (202-585-8730) or Susan Reaman (202-585-8327) of Nixon Peabody LLP should you have any questions. Thank you for consideration of our views.

Very truly yours,

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