

July 30, 2009

Mr. Michael F. Mundaca  
Acting Assistant Secretary (Tax Policy)  
Department of the Treasury  
1500 Pennsylvania Ave., NW  
Room 3120  
Washington, DC 20220

RE: Low-Income Housing Tax Credit Exchange Program  
(Section 1602 of the American Recovery and Reinvestment Act of 2009)

Dear Mr. Mundaca:

The LIHTC Working Group consists of low-income housing tax credit (“LIHTC”) industry participants including not-for-profit and for-profit developers, syndicators, investors, accountants and lawyers. Our goal is to work together to resolve technical and administrative LIHTC program issues. We are writing this letter to you on behalf of the LIHTC Working Group, along with the National Association of Home Builders. With this letter, we hope to bring to your attention questions that have arisen from Section 1602 of the American Recovery and Reinvestment Act of 2009 (“Section 1602”). We request that you add these issues to the list of IRS regulation projects and issue an IRS Notice outlining the guidance that the regulations will provide.

### **Partial Recapture**

Section 1602 states:

The State housing credit agency shall impose conditions or restrictions, including a requirement providing for recapture, on any subaward... so as to assure that the building with respect to which such subaward is made remains a qualified low-income building during the compliance period.

Furthermore, Section 1602 states:

Any such subaward with respect to any qualified low-income building shall be made in the same manner and shall be subject to the same limitations (including rent, income, and use restrictions on such building) as an allocation of housing credit dollar amount allocated by such State housing credit agency under section 42 of the Internal Revenue Code of 1986.

Within Internal Revenue Code (“IRC”) Section 42, subsection (j) provides for recapture of LIHTCs. Treasury has expressed its intentions to issue separate recapture procedures for Section 1602 funds.

As it pertains to the amount of recapture, Treasury stated in its Frequently Asked Questions and Answers Document released July 9, 2009 (“FAQs”), the amount of funds to be recaptured would be equal to “the full amount of the Section 1602 subaward... minus 6.67 percent (1/15<sup>th</sup>) for each full year of the building’s 15-year compliance where a Section 1602 recapture event has not occurred.” We believe that Treasury should allow for partial recapture since Section 1602 states that subawards be “made in the same manner and shall be subject to the same limitations as an allocation of housing credit dollar amount allocated by such State housing credit agency under section 42 of the Internal Revenue Code of 1986.” If a building has an applicable percentage of 100% (and 100 units of equal square footage), a decrease in 1% (or 1 unit) only causes the recapture of 1% under IRC Section 42(j). However, Treasury has stated that under Section 1602, if the Section 1602 percentage (defined as the percentage of Section 1602 funds that comprise the eligible basis of the building) is 100% and the applicable fraction expressed as a percentage is 100%, then a loss of 1 unit would cause 100% recapture of the remaining subaward. Thus, we believe that Treasury should allow for partial recapture when a building’s applicable fraction expressed as a percentage falls below the building’s Section 1602 percentage, but is greater than its minimum set-aside percentage. We propose that the amount of recapture be equal to 1/15<sup>th</sup> of the subaward times the percentage of the building that is out of compliance for each of the years remaining in the compliance period. This percentage would be equal to the new applicable fraction divided by the Section 1602 percentage and then subtracted from 1. We have attached Exhibit A to illustrate our calculation.

In the FAQs, question and answer #9(b), Treasury implies that recapture is on a building by building basis, but does not specifically address the issue of whether the recapture calculation is building by building or property based. We believe it should be building by building to keep in line with IRC Section 42. In addition, if the calculation is done on a building by building basis, the Section 1602 funds will have to be allocated among the buildings in a reasonable manner. We believe it makes sense to allocate the Section 1602 funds among the buildings pursuant to the Section 1602 subawardee document or other regulatory agreement. If the subawardee document or other regulatory agreement does not provide for an allocation among the buildings, then the project owner should be allowed to allocate the Section 1602 funds among the buildings using any reasonable method adopted by the taxpayer, such as affordable square footage or number of affordable units. This methodology would be more in line with IRC Section 42 and therefore the spirit of Section 1602.

### **Casualty Loss**

Since Treasury plans to replace IRC Section 42(j) with new rules as it pertains to subawards from Section 1602, we believe Treasury should also address other issues in IRC Section 42(j). One issue surrounds IRC Section 42(j)(4)(E) or recapture when a building has a casualty loss. Treasury has implied full recapture when a building’s applicable fraction expressed as a

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percentage is less than its Section 1602 percentage or minimum set-aside percentage. If a building were to suffer a casualty loss, without an exclusion for this type of situation, a building could be subject to full recapture. IRC Section 42(j)(4)(E) provides a cushion of a reasonable period of time to restore a building due to a casualty loss. We believe that a project owner should be able to cure the problem in a reasonable period of time without facing a loss of any of its subaward or recapture. We believe that this exception would be in line with IRC Section 42 and request Treasury's guidance on this issue.


### **Building Disposition during the Compliance Period**

Another provision in IRC Section 42(j) that needs to be addressed is the disposition of a building. Pursuant to IRC Section 42(j)(6), there is no recapture on the disposition of a building "if it is reasonably expected that such building will continue to be operated as a qualified low-income building for the remaining compliance period with respect to such building." Since this section is in IRC Section 42(j), which is being replaced by Treasury as it pertains to subawards, we believe that a building should still be able to rely on IRC Section 42(j)(6) when it disposes of a building during the compliance period and it is reasonable to expect that the new owners will continue to operate the building as a qualified low-income building for the remaining compliance period. Similar to the previous issue, we believe that this carve out should be included in Treasury's guidance on recapture, as it captures the intent of IRC Section 42.


Overall, we are requesting that Treasury issue detailed written guidance as to what is required of projects and states as it pertains to Section 1602. With tight timelines, as all funds need to be used to make subawards by January 1, 2011, we are requesting your written guidance as soon as possible. We appreciate your time and are available if there is any way we can be of assistance. Please feel free to contact Michael Novogradac (415) 356-8000 or Michael Morrison (415) 356-8025.

### **THE LIHTC WORKING GROUP**

Very truly yours,  
NOVOGRADAC & COMPANY LLP

by   
Michael J. Novogradac

NOVOGRADAC & COMPANY LLP

by   
Michael G. Morrison

### **THE NATIONAL ASSOCIATION OF HOME BUILDERS**

cc: Paul F. Handleman  
Jean Whaley

Attachment

**Exhibit A**  
**LIHTC Working Group Comments**

Example

	<u>Treasury Proposed Recapture Amount</u>	<u>LIHTC Working Group Proposed Recapture Amount</u>
Applicable Fraction	100%	100%
Minimum Set-Aside	40%	40%
Total Credit Exchange Dollars	\$ 4,250,000	\$ 4,250,000
Total Eligible Basis	\$ 5,000,000	\$ 5,000,000
Section 1602 Percentage	85.00%	85.00%
Year of recapture	Year 4	Year 4
New Applicable Fraction	75.00%	75.00%
Percentage of Building Out of Compliance	11.76%	11.76%
Subaward	\$ 4,250,000 1/15	\$ 4,250,000 1/15
	283,333	283,333
Remaining Years	12	12
Recapture	\$ 3,400,000	3,400,000
Percentage of Building Out of Compliance with Section 1602 Percentage		11.76%
Recapture		\$ 400,000