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February 27, 2013

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2012-25)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Notice 2012-25, Guidance Priority List

Dear Ladies and Gentlemen:

The LIHTC Working Group was established to provide a platform for low-income housing tax credit ("LIHTC") industry participants to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we are requesting guidance on questions regarding the application of Internal Revenue Code Section 42 ("Section 42") requirements as they conflict with the requirements of other affordable housing governmental assistance programs. We request that you add this issue to the list of current Internal Revenue Service ("IRS") regulation projects and the 2012-2013 Guidance Priority List, and issue an IRS Notice outlining the guidance that the regulations will provide.

Section 42 provides LIHTCs to investors through their investments in the construction of low-income housing projects, contingent on continued compliance with Section 42 guidelines over a 15-year compliance period[1]. In order to fund the construction of such projects, additional financing from other governmental assistance programs is often required. These assistance programs sources often have their own set of restrictions. In some instances, the existence of these additional restrictions creates conflicts between the guidelines under Section 42 and those under various housing programs. We believe that rental properties subject to the program requirements of Section 42 should be held harmless when complying with program requirements of other affordable housing governmental assistance programs.

In an August 20, 2007 memorandum to examiners assigned to LIHTC cases, Glenn DeLoriea, program manager of examination specialization and technical guidance in the IRS's Small Business/Self-Employed division has concluded that any project that fails to comply with the Section 42 requirements at any time during the 15-year compliance period never fully intended to comply with Section 42 and would not be considered a low-income property, and thus, should be subject to a loss of all future credits under said section, as well as a recapture of one-third of credits already received to that point[2]. The memo warns: "In any instance where the taxpayer

[1] Internal Revenue Code Section 42(h)(6)(D)(ii)(II)

[2] DeLoria, Glenn. Memorandum for Examiners Assigned Low-Income Housing Credit Cases, Internal Revenue Service, Washington, D.C. 20 August 2007.

has 1) established policies and/or procedures that are in conflict with Section 42 or 2) subordinated the requirements of Section 42 in favor of conflicting requirements for other programs, the project will be considered in a state of noncompliance."

The IRS cites a specific example in which the project is offered a state property tax abatement if all of the units in the project are occupied by low-income households whose income is less than 80 percent of the area median gross income ("AMGI") as defined by the U.S. Department of Housing and Urban Development ("HUD"). In the example, the property has elected the 40/60 minimum set-aside. In the initial move-in the property tax abatement income level will never conflict with the Section 42 rules. All tenants that move in have a total household income that is less than 60 percent of AMGI.

However, upon recertification the property tax abatement requirement may be more restrictive than the IRS requirement. The property tax abatement has no provision for over-income tenants. If a tenant's income rises above 80 percent of AMGI then the tenant must be evicted if the project is to continue to receive the necessary assistance. If the tenant is not evicted, the project ceases to qualify for the property tax abatement. Conversely, under the tax credit rules, as long as the tenant is still under 84 percent (140 percent of the 60 percent income limit), he or she is still considered a low-income tenant as he or she initially qualified and is therefore protected from being evicted.[3] Even if the tenant's income rises above 140 percent of the income limit, the IRS has indicated that it does not consider this "good cause" for eviction,[4] as the IRS relies on HUD Handbook 4350.3 as a benchmark for terminations of tenancy in the LIHTC program. If the property manager or owner evicts the tenant for being over-income, this violates the provisions of Section 42. In this situation, there is no way to satisfy both the Section 42 requirements and the property tax abatement requirements.

The position taken by the IRS, as described in the preceding paragraph, resulted in an official petition for readjustment of partnership items for a taxpayer.[5] El Patio Gardens Development Company (the "Petitioner") is the tax matters partner of El Patio Community Housing Partners, a limited partnership which receives annual LIHTCs from a project which is located in a state-level jurisdiction which allows property tax abatements to residential rental housing owners who rent to low-income tenants.[6] In the case of the property tax abatement, low-income tenants are evaluated as defined by HUD. Each household's income, therefore, must be below 80 percent of AMGI.

Following the IRS ruling on the matter, the Petitioner filed an appeal with the U.S. Tax Court, stating that the project in question had been following HUD-prescribed regulations concerning the determination of low-income individuals, and had denied renewal of leases to tenants who

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[3] Internal Revenue Code Section 42(g)(2)(D)(i)

[4] Internal Revenue Code Section 42(g)(2)(D)(ii)

[5] United States Tax Court: El Patio Community Housing Partners, El Patio Gardens Development Company, Tax Matters Partner, Petitioner, v. Commissioner of Internal Revenue, Respondent.

[6] California Revenue and Taxation Code Section 214

did not meet these specific qualifications in good faith. Prior to an official ruling by the court, the IRS conceded the case, allowing future Section 42 credits to be claimed by the Petitioner, as well as nullifying any previous notices of recapture of previously claimed credits.

In order to fulfill the primary goal of Section 42, namely, the service of the lowest income tenants for the longest period of time[7], projects must maintain economic feasibility, often through the use of subsidies intended to lessen the economic burden of low-income housing projects. Should projects be forced to sacrifice compliance with the requirements of said subsidies in favor of those outlined in Section 42, they could be subject to lost grants, financial subsidies, deferred payment loans, and additional expenses, which cannot be recoverable from increased rental revenue. Such expenses incurred for the maintenance of housing for over-income tenants can deal a great blow toward a low-income housing project's continued ability to serve the lowest income tenants over the longest period of time. Therefore, framed by the requirements of the state property tax abatement, a project's election not to renew leases belonging to over-income tenants in order to maintain compliance with the 80 percent AMGI threshold should constitute "good cause" and is, therefore, not in conflict with Section 42 requirements. Moreover, permitting a project the choice not to renew leases of over-income individuals is an action consistent with similar federal rules and housing policies as well as the primary goal of Section 42. For example, under HUD's Section 8 program, an owner can evict a tenant if there is "good cause", such as a business or economic reason (e.g., choosing to lease to an individual that is not over-income), as long as there is a 90-day notice provided to the tenant. Furthermore, the U.S. Department of Agriculture's Section 515 rural rental housing program requires that tenants that no longer comply with the income requirements of the program must be notified about vacating a property within 30 days or at the end of their lease, whichever is longer.[8]

Heretofore, there has been no official guidance regarding circumstances similar to those aforementioned. We request that the IRS issue guidance allowing a project to be held harmless from Section 42 credit recapture for not renewing leases of over-income tenants by virtue of its adherence to the requirements of other affordable housing governmental assistance programs, the requirements of which may be more restrictive and may be in conflict with Section 42's requirements, if such programs provide financial assistance to the project, enabling it to be operationally feasible. Furthermore, we request that this issue be added to the list of current IRS regulation projects and the 2012-2013 Guidance Priority List, and issue an IRS Notice outlining the guidance that the regulations will provide.

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[7] Internal Revenue Code Section 42(m)(1)(B)

[8] USDA Rural Development Handbook HB-2-3560

We appreciate the opportunity to comment on this issue. The furtherance of this issue will help the LIHTC program better provide affordable housing and help increase the number of jobs in our communities by providing clarification and lessening the risks in the LIHTC program compliance. Thank you in advance for your time and careful consideration of this issue. Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

THE LIHTC WORKING GROUP

Very truly yours,

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cc: Mr. Paul F. Handleman
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