STATE OF OREGON
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Donald Lee Korb
Chief Counsel
Internal Revenue Service
1111 Constitution Ave., NW, 3026 IR
Washington, DC 20224

Eric Solomon
Deputy Assistant Secretary, Regulatory Affairs
United States Treasury
1500 Pennsylvania Ave., NW, 3104 MT
Washington, DC 20220

RE: Interpretation of Section 42(h)(4) of the Internal Revenue Code

Dear Messrs. Korb and Solomon:
I write on behalf of the State of Oregon and its Private Activity Bond Committee to express our deep concern about an interpretation by the lawyers of the Internal Revenue Service of the low-income housing tax credit provisions that we believe to be contrary to the intent of Congress.

The State of Oregon has a great need for affordable, housing for its residents and a limited amount of the low income housing tax credit ceiling under section 42 of the Code and the private activity bond volume cap under section 146 of the Code to help in financing that need. We recognize that, in enacting the low income housing tax credit in 1986, Congress wanted to limit the federal tax expenditure associated with the tax credit. It sought to limit that credit by providing that tax credits were only available if, among other things, the project received an allocation of the low income housing ceiling or an allocation of the State private activity bond volume cap. Under section 42(h)(4), the credit is allowable with an allocation of the State private activity bond volume cap if at least 50% of the aggregate basis of land and building is financed with proceeds of tax-exempt private activity bonds and "such obligations are taken into account under section 146."

Our State, like many others, exhausts its low income housing credit ceiling quickly and has come to rely on the allocation of the State private activity bond volume cap to increase the availability of affordable rental housing projects. Allocation of the private activity bond volume cap is also very competitive, because we allocate the volume cap to bonds to finance competing priorities such as affordable single family housing and economic development projects. At times, we have had to allocate private activity bond volume cap for a project over a multi-year period if the full amount is not available in any particular year because of competing priorities for this volume cap.

It has recently come to our attention that the incremental allocation of bond volume cap for a housing tax credit project can jeopardize the tax credit if the tax-exempt bonds are refunded before the project is placed in service. For example, if sufficient volume cap were available at a later date to finance the additional construction costs on a tax-exempt basis, an initial series of tax-exempt bonds might be rolled into the subsequent bond financing through a refunding to

provide the permanent financing: Both the first and second series of tax-exempt debt would have received an allocation of the private activity bond volume cap upon original issuance.

We understand, however, that the Internal Revenue Service has taken the position that the refunding of the initial series of tax-exempt debt will not count toward the 50% test of section 42(h)(4) because section 1460) of the Code provides that a bond issued to refund another bond is not a private activity bond for purposes of section 146 to the extent that the amount of the refunding bond does not exceed the outstanding amount of the refunded bond. Although this is not a published position of the IRS, one of our issuers spoke with an attorney advisor in the Chief Counsel's Office of the Internal Revenue Service, who stated that the IRS has consistently taken this position before when asked by taxpayers and is not inclined to change it. also indicated that, given the current workload of the IRS, it was unlikely that published guidance would be issued to address this issue because the problem arises infrequently.

We believe that this position is contrary to the intent of Congress in enacting section 42(h)(4). The requirement that the obligation be subject to section 146 was intended to prevent the tax credit from being allocated under the 50% rule in cases where governmental bonds or qualified 501(c)(3) bonds, neither of which are ever subject to the private activity bond volume cap, were issued to finance the project costs. That is simply not the case here, where the principal amount of all bonds issued would be subject upon original issuance to the private activity bond volume cap. While the refunding bonds are not technically subject to the volume cap, it is only-because of the policy determination by Congress that project costs financed by the bonds need only be counted once toward the private activity bond volume cap.

Reading refunding bonds out of the definition of section 42(h)(4)(A) when they have complied with the intent of the restriction on private activity bonds subject to the volume cap defeats the desire of Congress to provide affordable housing within the limits it set. From our standpoint, this narrow interpretation thwarts our efforts to use our private activity bond volume cap in the most efficient and effective way given the many competing priorities in our State. If we make an allocation to a housing project that will only be built if the low income housing tax credit is available, we do not want to see it wasted if the plan of finance necessitates a refunding before the project is placed in service.

We are seeking your immediate assistance in rectifying this problem. While we are aware that we could submit a private letter ruling to the IRS seeking an interpretation of section 42(h)(4), we understand that the IRS is unlikely to agree with our interpretation and there is no procedure for appealing that private letter ruling. This issue is of deep concern to us and we would like to request a conference or public hearing as soon as possible to discuss how these differences in interpretation can be resolved to carry out the intent of Congress.

Sincerely,

Randall Edwards
Oregon State Treasurer
cc: Susan J. Reaman, Branch Chief IRS
Attorney-Advisor, IRS