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Congress of the United States

House of Representatives

COMMITTEE ON WAYS AND MEANS

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January 9, 2003

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The Honorable Mel Martinez
Secretary
Department of Housing and
Urban Development
451 7th Street S.W.
Washington, DC 20410

Dear Mr. Secretary:

I assume that you were not consulted when the President's dividend exemption proposal was developed. Therefore, you probably were not aware of its substantial adverse impact on the low-income housing credit. I am writing you to request your urgent assistance in changing the proposal or clarifying its impact so that the low-income housing tax credit program can maintain its record of effectiveness.

As you are aware, the low-income housing tax credit is the largest Federal program to provide low-income housing. The credit, in effect, provides an additional rate of return to the developer of low-income housing so that the developer can maintain low rental rates. Many developers of low-income housing are either tax-exempt or have relatively little tax liability. Therefore, the success of the low-income housing credit depends on the ability to syndicate the projects and, in effect, sell the credits to taxable corporations. Those corporations purchase the credit on a discounted basis. When they file their return, it appears that they receive large benefits from the low-income housing credit. The appearances are deceptive. The only benefit they receive is, in effect, an interest rate return reflected in the discount.

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Under the President's proposed stimulus package, corporations will be able to pay tax-exempt dividends out of income that is subject to the full corporate tax. It appears that corporations will not be able to pay tax-exempt dividends out of income, the tax on which was offset by the use of a tax credit, such as the low-income housing credit. The only credit exempt from this rule appears to be the foreign tax credit. You may wish to ask the Treasury Department why they took great care to protect a tax benefit available to corporations operating overseas, but chose to deny the benefit of domestic tax credits, such as the low-income housing credit.

The adverse impact of this proposal on the low-income housing credit can be demonstrated by a simplified example. Assume a corporation earned \$100 in taxable income. If the corporation did not utilize any tax credits, the corporation would pay a \$35 tax on that income. Under the President's proposal, all of that income could be distributed by the corporation without any tax at the shareholder level. However, if the corporation purchased low-income housing credits and used those credits to offset all of its tax on those earnings, the dividends paid out of those earnings would be fully taxable to the shareholders. This is true even though the corporation paid for those credits. As a result, the increase in shareholder tax would probably exceed the net benefit realized by the corporation from the credit. The low-income housing credit would be virtually worthless.


It is possible, but unlikely, that my understanding of the President's proposal is not correct. If my understanding is correct, the President's proposal could have a catastrophic impact on the low-income housing credit. Corporations who had purchased low-income housing credits in the past will find that they paid full value for something that is now virtually worthless. It is hard to see how future syndications of the credit can be accomplished.

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My initial reaction to the President's stimulus package was that it is unfair and reckless. The more I see of the details of his proposal, the more confident I am that my initial reaction was correct.

If you care at all about providing housing to the disadvantaged individuals in our society you should promptly attempt to intervene and get clarifications or changes to the President's proposal. I look forward to your prompt response on this issue because it is a matter of great concern to me.

Sincerely,



Charles B. Rangel
Ranking Democrat

CBR/mp