

# APPLEGATE & THORNE-THOMSEN

A PROFESSIONAL CORPORATION

322 SOUTH GREEN STREET  
SUITE 400  
CHICAGO, ILLINOIS 60607  
PHONE 312-421-8400  
FAX 312-421-6162

DIRECT DIAL:

BENNETT P. APPLGATE  
NICHOLAS J. BRUNICK  
MARK W. BURNS  
DIANE K. CORBETT  
PAUL DAVIS  
STEVEN D. FRIEDLAND  
GLENN A. GRAFF  
KELLI HARSCH  
NICOLE A. JACKSON  
CALEB A. JEWELL  
DEBRA A. KLEBAN  
PAVANTI PRASAD RUGG  
WILLIAM G. SKALITZKY  
KATHIE SOROKA  
BENJAMIN J. SWARTZENDRUBER  
THOMAS THORNE-THOMSEN  
WARREN P. WENZLOFF

July 20, 2009

Mr. Eric San Juan  
Acting Tax Legislative Counsel  
Office of the Tax Legislative Counsel  
Room 3044  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Mr. Richard Gregg  
Acting Fiscal Assistant to the Secretary  
Room 2112  
Department of the Treasury  
1500 Pennsylvania Ave, NW  
Washington, DC 20220

Mr. Paul Handleman  
Chief, Branch 5, CC: PSI  
IRS Office of Chief Counsel  
1111 Constitution Ave. NW  
Room 5111  
Washington DC 20224

Office of the Deputy Secretary  
Mr. Michael F. Mundaca  
Acting Assistant Secretary (Tax Policy)  
United States Department of Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Jean Whaley  
Grants Award Manager  
Department of the Treasury, Room 2045  
1500 Pennsylvania Ave., NW  
Washington, DC 20220

Congressman Barney Frank  
U.S. House of Representatives  
2252 Rayburn Building  
Washington, DC 20515

Re: American Recovery and Reinvestment Act – Tax Implications  
of Section 1602 Funds

Ladies and Gentleman:

Enclosed are comments concerning the tax treatment of subawards under Section 1602 of the American Recovery and Reinvestment Act of 2009, P.L. 111-5 as prepared by the below-identified members of the Tax Credit-Equity Financing Committee of the American Bar Association Forum on Affordable Housing and Community Development Law (“ABA Forum”). These comments reiterate some of the comments included in the May 5, 2009 letter that we

# APPLEGATE & THORNE-THOMSEN

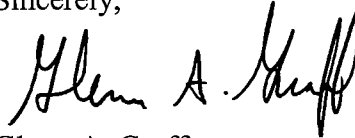
A PROFESSIONAL CORPORATION

Mr. Eric San Juan  
Mr. Kenneth Carfine  
Mr. Paul Handleman  
Mr. Michael F. Mundaca  
Congressman Barney Frank  
July 20, 2009  
Page 2

previously submitted. Due to the urgent need to receive written guidance on the below issues, we are submitting comments again.

These comments represent the individual views of those members who prepared them and do not represent the position of the American Bar Association, ABA Forum or the ABA Forum's Low-Income Housing Tax Credit Committee. I had principal responsibility for preparing these comments. The comments were approved by the following members of the Low-Income Housing Tax Credit Committee: Jerry Breed, Judy Crosby, Craig A. Emden, Peter L. Henderer, Lori Little, Julia C. Livingston, Brad M. Tomtishen, Forrest Milder and B. Susan Wilson.

Sincerely,



Glenn A. Graff  
Co-Chair, Low-Income Housing Tax Credit  
Committee of the American Bar Association  
Forum on Affordable Housing and  
Community Development Law

**I. EXECUTIVE SUMMARY**

The American Recovery and Reinvestment Act of 2009, P.L. 111-5 (“ARRA”) was signed into law on February 17, 2009. This letter concerns ARRA Division B, Section 1602 – Grants to States for Low-Income Housing in Lieu of Low-Income Housing Credit Allocations for 2009. This provision allows state credit agencies to subaward such funds to taxpayers developing qualified low-income buildings. Treasury has issued guidance stating that subawards must be granted to taxpayers. Guidance from the Internal Revenue Service is needed as to the tax results of receipt of a Section 1602 subaward.

**II. DISCUSSION**

**A. TAXABLE INCOME AND BASIS ISSUES RELATED TO EXCHANGE SUBAWARDS.**

**Question 1** – Does gross income include income from subawards of grants pursuant to Section 1602 of Division B (“Exchange Provision”)?

**Answer 1** – Gross income does not include income from the receipt of funds pursuant to Section 1602 of Division B of the American Recovery and Reinvestment Act of 2009.

Subawards of exchange funds are designed to function in two roles: (1) to fill the financial gap in projects that have an allocation of low-income housing tax credits (“LIHTC”) under Section 42 of the Internal Revenue Code of 1986, as amended (“Code”) but for which there are insufficient funds to build the project, and (2) for projects with no LIHTC investor interest, the subawards will be used to construct qualifying low-income buildings without the LIHTC as a funding source. Because the Exchange Provision requires adherence to requirements of Code Section 42, the grants cannot exceed the amount that the project will need for financial feasibility.

If the receipt of a grant of subaward funds is included in a recipient’s gross income, then a portion of the grant would end up being paid back to the Treasury as tax on the grant income. This would increase the financial gap of the project and require additional subawards to make the project financial feasible. In this regard, we note that Congress seemed to understand the necessity of not imposing tax on the receipt of funds under the Exchange Provision as the Joint Explanatory Statement states that “Grants under this provision are not taxable income to the recipients.”

We are requesting that the guidance refer to the grants as “not includible in gross income” to clarify the intention of Congress in using the language “grants under this provision are not taxable income to the recipients”. When Congress has intended to make income not included in taxable income, the general approach is to say such funds are not included in gross income. This was the approach with respect to energy grants provisions under ARRA. See ARRA § 1604 (IRC Section 48(d)(3)(A) amended to provide that such grants “shall not be

# APPLEGATE & THORNE-THOMSEN

A PROFESSIONAL CORPORATION

includible in the gross income of the taxpayer”). Such exclusion from gross income would be similar to the Section 103 exclusion from gross income for interest on state and municipal bonds, as well as many other sections of the code. In contrast, we are not aware of any Code Sections using language similar to the committee report’s language of “[g]rants under this provision are not taxable income to the recipients” and therefore the method to implement such exclusion from taxable income is unclear. This lack of clarity will led to numerous questions as to the proper method to reflect such income on tax returns, if such income should be reflected at all.

In conclusion, we request guidance confirming that gross income does not include a grant of a subaward pursuant to the Exchange Provision.

**Question 2** – Is either the “basis” or “eligible basis” of a qualified low-income building funded with a grant of a subaward reduced in an amount equal to the subaward?

**Answer 2** – Neither the basis nor the eligible basis of a qualified low-income building is reduced due to the presence of a grant of a subaward.

Under general rules of tax law, the receipt of a non-taxable grant generally results in the recipient receiving no basis in the asset purchased with the grant funds. However, Section 1404 of ARRA added a new Section 42(i)(9)(B) which provides that “Basis of a qualified low-income building shall not be reduced by the amount of any grant described in subparagraph (A).” The reference to “basis” logically would appear to be a reference to basis as defined under Section 1012. Thus it appears that ARRA has provided that a building’s depreciable basis would not be reduced by the amount of a grant of subaward funds.

Section 42(i)(9)(B) does not directly address a project’s eligible basis for purposes of Code Section 42. We note that Section 42(d)(5)(A) provides that “The eligible basis of a building shall not include any costs financed with the proceeds of a federally funded grant.” However, we believe that Congress intended that eligible basis should not be reduced for such a grant. As discussed above, it is clearly intended by the plain words of the statute that such grants can be used to fill financial gaps for projects that continue to use LIHTC as a funding source. However, if the receipt of a grant reduced a project’s eligible basis, then the amount of LIHTC that could be supported by the project would be reduced. This would increase the financial gap of the project and require additional grants of subaward funds which would then further decrease a project’s eligible basis and LIHTC repetitively. Given the Congressional limits on the amount of LIHTC which can be exchanged, this conclusion does not seem to fit the purpose of ARRA as the exchange program funds would not be able to create the intended qualified low-income buildings. We also note that if depreciable “basis” as discussed in the preceding paragraph is reduced for the amount of the grant, eligible basis would also be reduced creating the same financial shortfall issue.

In conclusion, we request guidance confirming that neither the eligible basis nor Section 1012 basis of a building must be reduced for the receipt of a grant of subaward funds.

**III. THE NEED FOR EXPEDITED WRITTEN GUIDANCE**

We would like to emphasize the need to receive written guidance that can be relied upon by taxpayers on the above issues. State credit agencies have been diligently working to create programs so that Section 1602 funds can be disbursed and the construction of affordable housing project may begin. Many projects will have both Section 1602 funds and equity derived from LIHTCs. However, the possibility that a Section 1602 grant would increase the gross income of the LIHTC partnership and thus increase the gross income of and taxes due from the LIHTC investor will have a chilling effect on investment in such projects. Delay in the receipt of such guidance will delay many projects, thus deferring the creation of affordable housing as well as the jobs associated with the housing.