Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2019-30)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2022-21 Recommendations for 2022-2023 Priority Guidance Plan

Ladies and Gentlemen:

We are writing in response to Notice 2022-21, in which the Service invited public comment on items that should be included on the 2022-2023 Priority Guidance Plan ("PGP"). The items below relate to the Low-Income Housing Tax Credit ("LIHTC") provided for under Section 42 of the Internal Revenue Code of 1986, as amended. The persons signing below are the primary authors of this letter. While we are all active members of the Tax Credit and Equity Financing Committee (the "Committee") of the American Bar Association's Forum on Affordable Housing and Community Development Law (the "Forum"), and while we have consulted with other members of the Committee and the Forum, this request is not made on behalf of the Forum and has not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, it should not be construed as representing the position of the Association. The suggestions included in this letter are also supported by the firms, organizations and individuals listed below.

Before describing our suggestions for matters which should be included on the PGP, we want to briefly address the ongoing regulations project with regard to the average income test provided by Section 42(g)(1)(C). Following the publication of the proposed regulations (Reg. 119890-18), many of the professionals in the affordable housing industry, as well as Enterprise and several housing-oriented associations and exempt organizations submitted significant comments, recommending substantial changes. Without final regulations that incorporate many of these recommendations, the Average Income Set-Aside has had and will continue to have very limited use due to both investor and developer concerns. Since these comments were submitted previously and because we understand from the Biden-Harris Administration Housing Supply Action Plan that the Service and Treasury plan to finalize updated regulations related to the Average Income Set Aside by the end of September 2022, we are not otherwise discussing the Average Income Test in the list below. However, we must emphasize the importance of the need for updated guidance on the average income test which addressed these primary issues of concern: (i) the inability to modify imputed unit designations, whether to address conflicts with other federal or local law (e.g. the Americans with Disabilities Act or the Violence Against Women Act), or simply as good business practice (e.g., on account of changes in family size or age of the tenants) and (ii) the undue weight which the proposed regulations place on occupancy of properly designated units which can cause a small number of non-compliant units to result in the total failure of the set-aside test.

As a group, we believed that there were many additional items for which guidance would lead to an improvement in the LIHTC program. However, we have been told that limiting our request to the most critical items would be helpful for the IRS. Therefore, below we have listed the top 5 items which we believe are the most critical issues related to LIHTC and have the highest need for formal guidance. While we believe that important guidance on some of these issues has been provided in recent years, we believe that further guidance on these items is still very important.

1. Federally or State-Assisted Buildings: We request guidance with respect to the amount and timing of assistance needed for an exception to the 10-year rule provided by Section 42(d)(6)(C).

Background: Section 42(d)(6)(C) provides an exception from the ten-year rule for the acquisition credit in the case of federally- or state-assisted buildings, defined as buildings which are "substantially assisted, financed, or operated" under certain programs of HUD, the Rural Housing Service, the Department of Agriculture, or similar state laws. This exception was provided as part of the Housing and Economic Recovery Act of 2008 ("HERA"). Although the statute defines what is meant by federally or state-assisted, it is not clear on two important points. First, it does not define what is meant by "substantially". Thus, for example, it is unclear whether a building that has project-based Section 8 assistance for 20% or 50% (or some other percentage) of the units is "substantially assisted." Second, it is not clear whether the assistance must have been provided prior to the acquisition of the building or if it could be added simultaneously with the acquisition, or simply be the subject of a commitment that has not yet been closed. For example, for buildings with FHA financing, it is not clear how much financing is needed to be substantially assisted, or whether FHA financing used to acquire a building (which did not previously have such assistance) is sufficient.

The members of the Tax Credit Equity and Financing Committee of the ABA Forum respectfully suggest that 20 percent should be considered "substantial" and a commitment to provide federal or state assistance at the time of acquisition of the project should be considered "assisted" for purposes of this exception.

Why guidance is needed now: Without guidance on the meaning or timing of substantially assisted, there is a reluctance to rely on this exception in many situations. As a result, many projects that were likely intended to qualify under the exception cannot generate the equity that these acquisition credits would produce. We respectfully note that the failure to provide guidance in the 14 years since this provision became law does not indicate that the housing community has developed a "work around." Instead, it simply makes the preservation and continued affordability of these projects more challenging and often impossible. Clear guidance would likely make it possible to preserve and improve many affordable housing units.

2. Guidance with Respect to Non-Profit Right of First Refusal: We request guidance as to the application of the right of first refusal provision in Section 42(i)(7) of the Code.

Background: IRC Section 42(i)(7) states that no tax benefits will "fail to be allowed" if certain persons, particularly a tenant, qualified nonprofit organization, or governmental agency, has a right of first refusal ("ROFR") to buy a building after the end of the compliance period for a price that is no less than the building's debt plus exit taxes. Congress included this ROFR provision to facilitate housing nonprofits, low-income tenants and governmental agencies acquiring LIHTC projects, so as to assure their continued availability as affordable housing. Unfortunately, there continues to be considerable confusion as to the steps which must be taken in connection with an ROFR, and the assets to which it applies. For example, it is unclear how it applies to the project reserves, which may be necessary to preserve the affordability of the project. To be helpful, guidance should include (1) whether a bona fide offer is necessary to trigger the right of first refusal or if simply offering the property for sale or even an agreement of the partners to proceed with a sale of the property is sufficient; (2) whether the right of first refusal applies only to a sale of the property or can it also apply to a sale of the limited partner's interest; and (3) what assets are covered by the ROFR.

Why guidance is needed now: The absence of guidance has resulted in disputes and (in recent years) significant and costly litigation among investors and non-profit general partners. This results in a considerable and needless waste of resources.

3. <u>Loss of Low Income Housing Tax Credits upon a Casualty Loss</u>: We recommend that the IRS reconsider its position that credits are not allowed for an entire year where there is a casualty that causes the building or units to not be available for occupancy on December 31st of that year, even where the building was in compliance for the entire year prior to the casualty and repairs are being undertaken diligently.

Background: Depending upon the circumstances, existing IRS guidance provides different rules for claiming credits than for recapture of previously claimed credits. In the case of a presidentially declared disaster area repairs completed within the reasonable period determined by the state housing agency (not more than 25 months) do not result in inability to claim credits or recapture. See Rev. Proc. 2007-54, and more recent guidance with respect to the COVID pandemic. However, for other casualty losses, December 31 remains a crucial date. While recapture does not result if the building or units are restored within a reasonable period of time (again, as determined by the state housing agency, with a maximum of 180 days), a taxpayer cannot claim the current year's credits if the building is not restored by the end of the year. See Chief Counsel Advice 200913012 and 200134006. Although the ability to claim credits would resume for the year in which such a project is returned to service, the credits lost in the year of the casualty that was not repaired by December 31 are not made up later, making this a permanent loss of credits. For example, where a building is in service from January 1 through December 30 but suffers a fire and goes out of service on December 31, the full year of credits are lost. On the other hand, if a building is out of service from January 2 through December 30, but returns to use on December 31, the credits are not lost.

We request that the IRS revise its policy and provide the same treatment for all casualty losses as is now provided for losses in a presidentially-declared disaster area. In general, tax law provides a time-period for replacements to be completed for casualties and avoid recapture, even if not located in a disaster area. (See Internal Revenue Code Section 1033(a)(2)(B.) If restored within that time-period, there should be no loss of tax credit, even if the building is not restored until after the end of the year.

Why guidance is needed now: Each year projects have fires, floods and other disasters that cannot be predicted or avoided. If a casualty happens late in the year it becomes impossible for even the most diligent owner to avoid a loss of credits and the potential failure of the project. In some cases, this can lead to a decision to just use insurance proceeds to pay recapture tax and not restore the building. That leads to an unfortunate and unnecessary loss in affordable housing.

4. <u>Loss of Tax Credit for Erroneous Overcharging of Rent</u>: We request guidance that would provide that an inadvertent de minimis overcharge in rent would not cause loss of LIHTC credits or LIHTC recapture.

Background: Under Section 42, rents must not exceed 30% of the applicable rent limitation, either 50% or 60% of area median income. Occasionally, an owner inadvertently overcharges rent to tenant. We understand that the IRS has sometimes advised that recapture should apply even where the error was small, inadvertent, and the taxpayer took steps to promptly correct the error. For example, this can occur when there is a change in utility allowances about which the owner was not aware, even if the owner corrects its error promptly upon realizing the error.

To avoid any inadvertent benefit to the owner, guidance should require the owner to promptly refund such overcharge to current and former tenants, as well as pay such tenants an appropriate amount of interest.

Why guidance is needed now: With the complexities involved in computing permissible LIHTC rents, especially as utility allowances can often change, a de minimis overcharge in rent can easily occur. In a normal landlord-tenant relationship, an overpayment of rent would simply be corrected by a refund or adjustment in the next month's rent. Guidance confirming the appropriateness of this approach would clarify what an owner should do when it inadvertently finds itself in such a situation. If there is a way for an owner to properly correct for such an error without a punitive loss of credits and recapture, then owners will be incentivized to correct such errors and make tenants whole.

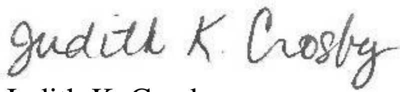
5. <u>Planned Foreclosures and Their Impact</u>: We request guidance as to when a foreclosure is part of an arrangement to terminate an extended use agreement.

Background: The purpose of an extended use agreement is to provide continued affordability to tenants. The Code provides that most foreclosures would terminate an extended use agreement. However, Section 42(h)(6)(E)(i)(I) provides that a foreclosure will not terminate an extended use agreement if the "Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period". Unfortunately, it is not clear how the IRS would become aware of such an arrangement, or what tests it would apply to the particular facts. Guidance might take several forms. For example, it might call for notice to the IRS and local agencies before the termination became effective, or a procedure for requesting a ruling on whether a foreclosure is part of an improper arrangement, as well as what factors should be considered in making such a determination. It should be noted that a mere "related party" test may be insufficient here, as many banks and similar lenders are also investors, and for a troubled project, foreclosure may be an appropriate remedy.

Why guidance is needed now: In the absence of guidance or an IRS process for determining if a foreclosure is legitimate or not, we understand that some extended use agreements have been terminated in questionable situations. This can mean that some low-income tenants will either be forced to move or pay market rents that are substantially more than they can afford. Currently, we believe questionable planned foreclosures have occurred in a limited number of cases. However, if guidance is not provided, we may see a significant and unwelcome rise in terminating 30-year affordability covenants. At the same time, IRS guidance is needed to assure that legitimate lenders, who are a critical part of financing LIHTC projects, maintain their proper rights to foreclosure.

We appreciate the opportunity to submit requests for Priority Guidance. We hope our suggestions will be helpful. We would be happy to submit a white paper in support of any of these points. Please feel free to contact us.

Sincerely,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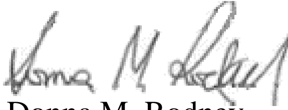
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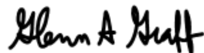
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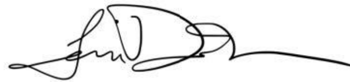
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