Council for Affordable and Rural Housing
Serving the Affordable Housing Needs of Rural America

April 15, 2013

Ways and Means Committee
U.S. House of Representatives
1106 Longworth House Office Building
Washington DC 20515

Attn: Income and Tax Distribution Working Group
Hon. Lynn Jenkins
Hon. Joseph Crowley

Attn: Real Estate Working Group
Hon. Sam Johnson
Hon. Bill Pascrell, Jr.

Attn: Small Business/Pass Throughs Working Group
Hon. Vern Buchanan
Hon. Allyson Schwartz

RE: Ways and Means Tax Reform Working Groups

Ladies and Gentlemen:

The Council for Affordable and Rural Housing ("CARH") appreciates the opportunity to provide feedback on the work of the House Ways and Means Committee Tax Reform Working Groups as they review our nation's tax law and identify opportunities for meaningful reform. CARH writes to emphasize the importance of the Low-Income Housing Tax Credit, and to identify two reform opportunities—one that would increase the effectiveness of the LIHTC program by allowing for greater leverage of private funds through the program; and another to better align taxpayers' incentives with the government's interest in providing decent and affordable housing to rural areas.

CARH represents more than 300 non-profit and for-profit housing providers and local trade associations in America's rural communities. For over 30 years, CARH has served as the nation's premier association for participants in the affordable rural housing profession, including builders, owners, developers, managers, non-profits, housing authorities, syndicators, accountants, architects, attorneys, bankers, and companies that supply goods and services to this vital industry housing elderly and disabled residents and working families throughout rural America.

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I. CARH Supports Continuing and Strengthening the LIHTC Program

The Low Income Housing Tax Credit (LIHTC) program has been a great success and a strong support to affordable housing for low-income Americans. Continuing the LIHTC program is vital to the future of affordable housing, both in general and specifically in rural areas. Since its creation in 1986, the LIHTC program has provided the basis for numerous public-private partnerships and incentivized the leveraging of private investment with public funding sources. These partnerships and leveraging are frequently necessary to allow for the construction and rehabilitation of housing that serves the most vulnerable Americans. The LIHTC program has been a crucial support not only for the creation of new affordable housing but also for the renovation and preservation of the existing affordable housing stock in rural areas and elsewhere. CARH strongly supports the LIHTC program and urges the Committee and its Working Groups to support continuing the program and its success.

II. Reform of Passive Activity Loss Limitations

CARH also believes that tax reform can improve an already successful program. LIHTC is based on corporate investment, with strictly limited personal or non-corporate investment. If well-capitalized community banks, many of which are organized as limited liability companies or S corporations, and are located in rural areas, could invest in the LIHTC program, more LIHTCs would be more available for rural transactions and pricing would be higher.

A number of these organizations have approached CARH over the years about investing in LIHTCs, but the Internal Revenue Code's restrictions on use of losses from passive activities present an issue. The Code currently includes a rule limiting the extent to which individual investors may include net losses from passive investments, including real estate. This limits the ability of associations that are not real estate professionals from investing in LIHTC projects and artificially limits the competition for tax credit investment opportunities. The limitations apply to the LIHTC program, with an exception allowing investors to take credits each year up to an equivalent of $25,000 in deductions. This also affects certain pass-through entities—including certain partnerships, LLCs and S corporations—and closely-held C corporations.

Local community banks should be allowed to invest in their communities through LIHTCs to the same degree LIHTCs are currently available to widely held C Corporations. To ensure high standards of oversight, such entities should have at least $10 million in annual gross receipts, be formed for reasons other than just avoidance of Federal income tax, and have an expectation of reasonable asset management. This proposal is aimed at accessing substantial investment capital available from sophisticated financial institutions and businesses that happen not to be C Corporations. Indeed, this change would allow the 1,954 commercial banks and 55 savings institutions to invest in low-income housing tax credits in the communities in which they operate.

III. Targeted Exit Tax Relief To Aid Preservation And Mitigate an Unintended Harm

Tax reform should also provide limited relief from exit tax burdens that discourage cost-effective preservation of existing affordable housing. Similar legislation has been introduced in previous congresses.

The Section 515 rural housing program, funded by private capital and government funds under Section 515 of the Housing Act of 1949, was for many years the most important affordable housing production program for rural America. This housing was built using very low interest rate government loans and private capital raised through the provision of tax benefits. Ominously, the current stock of Section 515 housing is at considerable risk due to the interplay between the design of the program and the tax depreciation recapture rules.

Real estate of all types is periodically updated and rehabilitated as an essential part of property operation and maintenance. Without periodic injections of new investment capital to fund these renovations, projects deteriorate, even to the point that they are unsafe or unsanitary. Maintenance of the existing housing stock is generally more cost effective than fixing or replacing a building that has been allowed to deteriorate.

However, almost all Section 515 properties were constructed through limited partnership arrangements whose structure makes it exceedingly difficult to introduce new capital into these properties, either through additional capital contributions from current owners or through the transfer of such properties to new owners. Because of rent restrictions that limit any cash flow from the property, new capital contributions would only generate additional passive losses which cannot be utilized by current investors. Yet, if the current owners sell the property it is almost impossible to generate sufficient cash to pay off the steep recapture taxes that would be owed. The best alternative for current limited partners is to hold the investment until death, enabling their heirs to acquire the property with a stepped up basis that avoids any recapture taxes.

Most Section 515 properties were also developed before 1986 and the Tax Reform Act. As a result, owners were locked in to the program without receiving most anticipated benefits. A modest change in the tax rules would allow owners to at least exit out of the program and permit preservation of this affordable housing at minimal revenue cost to the federal government. Most of these owners are individuals who invested decades ago in small apartment complexes (average size 24 units) and are now elderly and often seeking to retire.

The depreciation recapture tax liability should be waived if investors sell their property to new owners who agree to invest new capital in the property and to preserve the property as affordable housing for another 30 years. Since in practice very few investors facing this choice pay recapture taxes—opting instead to pass on the property to their heirs at a stepped-up basis—this proposal would result in little foregone tax and the true cost would be modest. The benefit to the federal government would be far reaching: allowing for economically motivated rather than tax-driven uses of these existing resources, and preserving existing affordable housing and extending its affordability in a cost-efficient manner. By incentivizing rehabilitation projects, this proposal would also lead to employment in rural areas across the country. In addition to the public benefit, this additional economic activity may result in other tax revenues to the federal government as well as state and local governments. And, this waiver could be limited to where cash is not available to the seller's net expenses. This way, where there is net cash to the seller, it is unlocked and the federal government would recover tax payments.

IV. Support the Administration's LIHTC Improvements

The President's Fiscal Year 2014 budget proposal recommends several changes to the LIHTC program. CARH supports the proposals to convert some private activity bond volume cap into authority to allocate additional LIHTCs. CARH also supports the proposals to expand resources to households in the greatest need through income averaging. These proposals will facilitate tax credits as a resource that flows to benefit households with the greatest need. Finally, CARH also supports changing the formula to determine 9 percent and 4 percent rates to provide a flat or more consistent credit rate. This will greatly aid simplification and predictability, making the LIHTC even more marketable and further reducing program costs.

CARH appreciates the opportunity to comment on the work of the Ways and Means Committee and looks forward to additional opportunities to provide feedback to support the ongoing tax reform effort. If you have any questions about the foregoing, please contact me at (703) 837-9001 or cfisher@carh.org.

Sincerely,

Colleen M. Fisher

Colleen M. Fisher
Executive Director