



# What's News in Tax

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## Government Accounting Office Recommends Ways to Strengthen the Low-Income Housing Credit Program

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Representatives from the Government Accounting Office (“GAO”) recently testified before the Senate Finance Committee on ways to improve the low-income housing tax credit (“LIHTC”), a federal tax credit for investors in low-income housing projects.<sup>1</sup> Under the LIHTC program, state and local housing finance agencies (“Allocating Agencies”) allocate LIHTC tax credit authority to developers and monitor compliance of multifamily housing projects financed through the LIHTC program. The testimony was based on three GAO reports<sup>2</sup> that found the Allocating Agencies’ requirements for allocating credits, reviewing costs, and monitoring compliance vary from state to state. Also, certain day-to-day administration practices raised concerns because they were not consistent with the LIHTC federal tax requirements imposed on Allocating Agencies. This article provides highlights from the GAO testimony, as well as its recommendations for improving oversight of the LIHTC program.

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<sup>1</sup> “Low-Income House Tax Credit: Actions Needed to Strengthen Oversight and Accountability,” Highlights of GAO-17-784T, testimony before the Committee on Finance, U.S. Senate (Aug. 2017).

<sup>2</sup> “Low-Income Housing Tax Credit: Joint IRS-HUD Administration Could Help Address Weaknesses in Oversight,” GAO-15-330 (July 2015); “Low-Income Housing Tax Credit: Some Agency Practices Raise Concerns and IRS Could Improve Noncompliance Reporting and Data Collection,” GAO-16-360 (May 2016); “Low-Income Housing Tax Credit: The Role of Syndicators,” GAO-17-285R (Feb. 2017).

## How the LIHTC Works

According to the U.S. Department of Housing and Urban Development (“HUD”) LIHTC data base,<sup>3</sup> over 2.97 million multifamily housing units have been placed in service between 1987 and 2015 under the LIHTC program.

Investors receive a federal tax credit for investments in low-income housing projects. The amount of the annual credit equals a percentage of a building’s eligible basis relating to the low-income units times the tax credit rate for each year of the 10-year credit period.

For new construction and qualified rehabilitations costs, the tax rate is fixed at 9 percent.<sup>4</sup> For existing buildings and tax-exempt bond-financed buildings, the tax rate is currently 3.22 percent,<sup>5</sup> calculated on approximately 30 percent of the building’s qualified basis.

Generally, eligible basis is equal to the building’s adjusted depreciable basis, certain tangible property such as refrigerators and stoves, and certain common area costs. However, special rules allow a building’s eligible basis to be increased by up to 130 percent if it is located in a qualified census tract or in an area that is difficult to develop. In addition, Allocating Agencies may designate a non-tax-exempt bond financed building as being located in a difficult to develop area in order for the project to be financially feasible as a low-income housing project.<sup>6</sup>

For a project to qualify as a LIHTC project, a certain percentage of the units must be low-income units.<sup>7</sup> Under this rule, the owner of the project may elect that either:

- ♦ 20 percent of the units be occupied by tenants earning 50 percent or less of the area median income or
- ♦ 40 percent of the units be occupied by tenants earning 60 percent or less of the area median income.

In addition, the rents on low-income units must be no more than 30 percent of the income limitation as elected by the owner. The minimum set-aside of low-income units and rent restriction requirements must remain in place throughout the 15-year LIHTC compliance period<sup>8</sup> plus an additional minimum 15-year extended low-income housing commitment period as agreed to between the owner and the Allocating Agency.<sup>9</sup>

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<sup>3</sup> <https://lihtc.huduser.gov/> (revised as of July 10, 2017).

<sup>4</sup> Section 42(b)(2). Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

<sup>5</sup> Rev. Rul. 2017-15, 2017-32 I.R.B. 176

<sup>6</sup> Section 42(d)(5).

<sup>7</sup> Section 42(i)(3).

<sup>8</sup> Section 42(i)(1).

<sup>9</sup> Section 42(h)(6).

Recapture can occur at any time during the 15-year compliance period. Generally a recapture event occurs if the percentage of low-income units decreases from the previous year.<sup>10</sup> While a qualified low-income building must remain in compliance for 15 years, the LIHTC is claimed over an accelerated 10-year credit period. The credit recapture amount equals the one-third accelerated portion of the credit claimed in all previous years with respect to the decrease in qualified basis plus interest at the overpayment rate.<sup>11</sup>

There is no recapture for a disposition of the building or an interest in a LIHTC building held through a partnership if a reasonable expectation exists that the purchaser will continue to maintain the building as a qualified low-income housing project.<sup>12</sup>

Each Allocating Agency receives a tax credit allocation amount based on population times a dollar amount (adjusted for inflation). For 2017 allocations, the credit allocation is equal to the greater of: \$2.35 times the state population or \$2,710,000.<sup>13</sup>

Allocating Agencies review developer applications, rate projects, and allocate credits to projects under their qualified allocation plans. State qualified allocation plans must contain specific criteria as set forth under the LIHTC rules including:

- ♦ Giving preference to projects serving the lowest income tenants
- ♦ Giving preference to projects that contribute to a concerted community revitalization plan
- ♦ Providing a procedure that the Allocating Agency will follow in monitoring for noncompliance
- ♦ Providing a process for notifying the IRS of noncompliance, and monitoring for noncompliance with habitability standards through regular site visits<sup>14</sup>

The LIHTC program requires that Allocating Agencies review each project under the specific criteria of its qualified allocation plan. Ultimately, this process allows each Allocating Agency to select those projects that will have the greatest impact on its state's housing needs. In addition, Allocating Agencies must enter into regulatory agreements with the owners of LIHTC projects to maintain LIHTC requirements—including any special state housing needs for an extended period beyond the LIHTC compliance period.

## GAO Testimony

The GAO testified that—based upon their sampling of 58 Allocating Agencies—qualified allocation plans did not always mention all selection criteria and preferences as required under the LIHTC rules.

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<sup>10</sup> Section 42(j)(1).

<sup>11</sup> Section 42(j)(2).

<sup>12</sup> Section 42(j)(6).

<sup>13</sup> Rev. Proc. 2016-55, 2016-45 IRB 707.

<sup>14</sup> Section 42(m)(1).

Also, when Allocating Agencies increased eligible basis, they did not always provide documentation to justify their selections and the justification provided for increased basis varied from state to state.

In addition, because of the IRS's limited review of the state Allocating Agencies practices and compliance procedures, the GAO recommended that Congress consider designating certain oversight responsibilities to HUD because the agency, which has a housing mission, collects and analyzes information on low-income rental housing, including LIHTC-funded projects, and has experience working with the Allocating Agencies. The GAO also concluded that leveraging the experience and expertise of another agency with a housing mission, such as HUD, might help offset some of the IRS's limitations in relation to program oversight.

Adopting this recommendation would have the effect of adding a third layer of regulatory review to the LIHTC program, significantly adding to the regulatory burden of multi-family housing developers. If improved oversight could be achieved, perhaps through increase IRS staffing, then HUD review might not be necessary.

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