Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2017-28)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2017-28 Recommendations for 2017-2018 Priority Guidance Plan

Ladies and Gentlemen:

We are writing in response to Notice 2017-28, in which the Service invited public comment on items that should be included on the 2017-2018 Priority Guidance Plan. 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. This response was prepared by members of the Tax Credit Equity and Financing Committee of the American Bar Association on Affordable Housing and Community Development Law ("ABA Forum"). The suggestions included in this letter are also supported by the additional organizations and people listed below.

As a group, we believed that there were many 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 please find the top 5 items which we believe are the most critical issues related to LIHTC and have the highest need for formal guidance.

1. <u>Federally or State-Assisted Buildings</u>. We request guidance with respect to the amount and timing of assistance needed for an exception to the 10-year rule.

Background: Section 42(d)(6)(C) provides an exception from the ten-year rule for the acquisition credit in the case of substantially federally or state-assisted buildings. 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% 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 in connection with the acquisition. 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.

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. This makes the preservation and continued affordability of these projects more challenging and often impossible.

2. <u>Guidance with Respect to Non-Profit Right of First Refusal</u>: 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 be lost 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 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 even litigation among investors and the non-profit general partners or sponsors and the inability of the non-profit partner or sponsor to exercise such rights and secure ownership of the property at the permitted price. This results in a considerable and needless waste of resources, as well as frustrating congressional objectives.

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, where the building was in compliance prior to the casualty and repairs are being undertaken diligently.

Background: The IRS already applies such a rule in the case of a presidentially declared disaster area. See Rev. Proc. 2007-54. 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, if not restored by the end of the year, no credits are allowed for that year. See Chief Counsel Advice 200913012 and 200134006. Although credits would resume for the year in which the project is returned to service, these are credits that the owner would have been entitled to had the casualty not occurred. Credits would be lost for any year in which the units are not returned to service by the end of the year, regardless of when the casualty occurred, and these credits are not made up later, as in the 11th year, so it is 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 credits are lost. On the other hand, if a building is out of service from January 2 through December 30, and returns to use on December 31, the credits are not lost.

We request that the Service revise its policy and provide the same treatment for casualty losses that are not located in a presidentially-declared disaster area as for those in such areas. 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. 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 loss in affordable housing.

4. Loss of Tax Credit for Erroneous Overcharging of Rent: 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 in 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 while most foreclosures would terminate an extended use agreement. 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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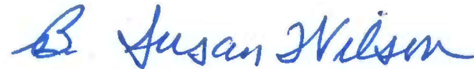

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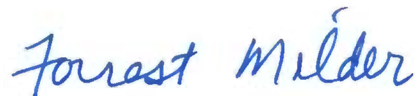

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