Client Alert

Current Issues Relevant to Our Clients

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Camp Proposal Would Eliminate 4% Low Income Housing Tax Credits

Legislative proposals by House Ways and Means Committee Chair Dave Camp would repeal the 4% LIHTC and change the way LIHTCs are allocated by the States. The proposals would also extend the period over which the LIHTC is recognized by the investors.

After several months of hearings on comprehensive tax reform, on February 26, 2014, Representative Camp released a tax bill referred to as the Tax Reform Act of 2014. The following is a summary of certain proposed changes related to low-income housing. We have also prepared summaries of other provisions relevant to other topical areas—please check our website for those. Although the Tax Reform Act of 2014 has not yet been formally introduced as a bill, and its prospects for passage are uncertain at this point, given the significant nature of the proposed reforms we will monitor their progress and provide updates as warranted.

Current Law

Under current law, owners of certain residential rental property may claim a low income housing tax credit (LIHTC) over a ten-year period for the cost of rental housing occupied by qualifying low-income tenants. However, rental housing must remain qualified low-income housing for a 15-year compliance period, beginning with the first year of the credit period (even though the credit period is only ten years). The amount of the credit for any tax year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The applicable percentage is adjusted monthly by the IRS so that the ten annual installments of the credit have a present value of either 70% or 30% of the total qualified basis.

In general, buildings subject to the 70% rule should yield a 9% credit, and buildings subject to the 30% rule should yield a 4% credit, although the credit amounts depend on the applicable interest rate used for discounting the building's basis for the particular tax year. A temporary provision under current law provided an applicable percentage of 9% with respect to the 70% rule for newly constructed non-Federally subsidized buildings placed in service before 2014.

Housing that qualifies for the 9% credit must be either newly constructed or substantially rehabilitated, and may not be Federally subsidized (including through tax-exempt bond financing). A new building generally is considered Federally subsidized if it also receives tax-exempt bond financing. The 4% credit is available, in general, for Federally subsidized buildings and existing housing.

To claim the credit, the owner of a qualified building must generally receive a housing credit allocation from the State or local housing credit agency.

Property subject to the credit generally must continue to be a low-income housing project for a compliance period of 15 years, beginning on the first day of the first tax year in which the credit is claimed. The penalty for any building failing to remain qualified is the recapture of the accelerated portion of the credit, with interest, for all prior years. Generally, a change in ownership of a building is a recapture event, subject to an exception if it can reasonably be expected that the building will continue to be operated as qualified low-income housing for the remainder of the compliance period.

Proposed Rule

Allocation of basis: Under the provision, State and local housing authorities would allocate qualified basis, rather than credit amounts. The annual amount of allocable basis for each State would be equal to $31.20 multiplied by the State's population, with a minimum annual amount of $36,300,000.

Credit period: Under the provision, the credit period would be extended from 10 years to 15 years to match the current 15-year compliance period. Because the credit period would be aligned with the compliance period, the recapture rules also would be repealed as no longer necessary to ensure that the building continues to be a low-income housing project for the duration of the tax benefit.

Credit amount: Under the provision, the 4% credit would be repealed. The 9% credit for newly constructed property and substantial rehabilitations would be retained. In addition, Federally funded grants would not be taken into account in determining the eligible basis of a building for purposes of the credit. As a result, the credit would apply to private funding of low-income housing and not provide an additional subsidy for Federal funding of such projects. The amount of the credit would continue to equal the qualified basis in the qualified low-income building multiplied by the applicable percentage. Under the provision, the IRS would determine the applicable percentage generally for the month that the building is placed in service, which would be equal to the percentage that would yield over a 15-year period a credit amount that would have a present building value equal to 70% of the qualified basis.

Other changes: Under the provision, several other rules would be modified. First, the increased basis rule for high-cost and difficult development areas would be repealed. Second, the general public-use requirement would be revised to eliminate the special occupancy preference for members of specific groups under certain Federal or State programs and the special preference for individuals involved in artistic and literary activities. Instead, occupancy preferences would only be permitted for individuals with special needs and for veterans. Third, the provision would repeal the requirement that States include in their low income-housing selection criteria the energy efficiency of the project and the historic nature of the project.

To the extent that any part of this summary is interpreted as being tax advice, (i) no taxpayer may rely upon this summary for the purposes of avoiding penalties, (ii) this summary may be interpreted for tax purposes as being prepared in connection with the promotion of the transactions described, and (iii) taxpayers should consult independent tax advisors.

For More Information

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