

Low-Income Housing Tax Credit Provisions in the Housing and Economic Recovery Act of 2008

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The Housing and Economic Recovery Act of 2008¹ (the “**Act**”) includes significant modifications affecting low-income housing tax credits (“**Housing Tax Credits**”) under Section 42 of the Internal Revenue Code of 1986, as amended (the “**Code**”), and related matters.

Repeal of Alternative Minimum Tax (“AMT”) Limitations on Housing Tax Credits, Historic Rehabilitation Tax Credits, and Tax-Exempt Housing Bonds

- Housing Tax Credits (for buildings placed in service after 2007) and historic rehabilitation tax credits under Code Section 47 (for qualified rehabilitation expenses taken into account after 2007) can now be used to offset the AMT.
- Interest on certain tax-exempt bonds issued after July 30, 2008 and used to finance affordable housing projects is not an AMT preference item.

Repeal of Recapture Bond Requirement

- Taxpayers are no longer required to post a bond when a building generating Housing Tax Credits is sold (or when an indirect interest in such a building is sold, such as an interest held through a partnership), provided that it is

reasonably expected that such building will continue to be operated as a qualified low-income building for the remainder of the 15-year Housing Tax Credit compliance period.

- If a building (or interest therein) is sold during the 15-year compliance period and there is a subsequent reduction in qualified basis causing an increase in tax, then the three-year statute of limitations for the Internal Revenue Service to assess a deficiency will not begin to run until the taxpayer notifies the Internal Revenue Service of such decrease in qualified basis.
- The repeal of the recapture bond requirement applies to dispositions of buildings (or interests therein) occurring after July 30, 2008 and to prior dispositions if the taxpayer affirmatively elects to apply the new provision to such earlier disposition.

Housing Tax Credit Percentages—Applicable Percentage Floor for Non-Federally Subsidized Buildings; Below-Market Federal Loans No Longer Treated As Federal Subsidy

- New low-income residential rental buildings that are not financed with tax-exempt bonds and that are placed in

service after July 30, 2008 and before December 31, 2013 are eligible for Housing Tax Credits using an applicable percentage equal to the greater of 9% or the percentage that would yield Housing Tax Credits during the 10-year credit period with a present value equal to 70% of the building's qualified basis (the "9% Housing Tax Credit").

- Both existing buildings (whether or not financed with tax-exempt bonds) and new buildings that are financed with tax-exempt bonds will continue to be treated as federally subsidized and, thus, only eligible for the 30% present value Housing Tax Credit. The current rules with respect to floating applicable percentages will continue to apply to such buildings.
- Buildings will not be treated as federally subsidized due to being financed with below-market federal loans. Thus, such buildings may be eligible for the 9% Housing Tax Credit.

Eligible Basis—Basis Boost Determinations Made By State Credit Agencies; Increase in Allowable Community Service Facility Space; Clarification of Treatment of Federal Grants; Modification of Related Party Rule for Acquisitions

- The 30% eligible basis boost for buildings located in difficult development areas or qualified census tracts is available for any building designated by the State Credit Agency as requiring the basis boost in order to be financially feasible as part of a qualified low-income housing project.
- The limitation on the allowable amount of eligible basis attributable to a qualified community service facility is increased to (1) 25% of the first \$15,000,000 of the eligible basis of the project, plus (2) 10% of any eligible

basis of such project in excess of \$15,000,000.

- The Act clarifies that only those costs financed with the proceeds of a federally-funded grant cannot be included in eligible basis. Federal grants used to finance operations of a building are not subject to the exclusion from eligible basis. Moreover, the legislative history to the Act provides that existing Treasury Regulations should be modified to clarify that federal grants do not include certain types of operating subsidies, including but not limited to interest reduction payments under Section 236 of the National Housing Act, certain rental assistance payments, and any other ongoing payment used to enable the property to be rented to low-income tenants.²
- For purposes of determining whether an existing building has previously been placed in service by a related party to the taxpayer (which will cause the building to be ineligible for acquisition Housing Tax Credits), the common ownership threshold establishing a related party relationship is increased from 10% to 50%.
- The requirement that eligible basis could not include existing buildings that have been placed in service within the previous ten years no longer applies to buildings that receive federal assistance under Section 8, of the United States Housing Act of 1937, Sections 221(d)(3), 221(d)(4) or 236 of the National Housing Act or Section 515 of the Housing Act of 1949, any other housing program administered by HUD or RHS or similar state assistance programs.

Temporary Increases in State Housing Tax Credit Ceiling Amounts and Tax-Exempt Bond Volume Cap

- The State Housing Tax Credit ceiling amount is increased for 2008 and 2009 by \$0.20 multiplied by the population of the State.
- The tax-exempt bond volume cap is increased for 2008 by \$10,000,000,000, allocated among the states in proportion to total population, to be used for financing certain qualified multifamily residential rental projects and single-family residences. Any unused amounts of such increased volume cap will be carried forward to qualified bond issuances in 2009 or 2010.

Increase in Minimum Required Rehabilitation Expenditures

- In order for rehabilitation expenditures to qualify for treatment as a separate new building, the minimum amount of such expenditures required to be incurred within a 24-month period is increased to the greater of (1) 20% of the of the adjusted basis of the building, or (2) \$6,000 per low-income unit (increased annually for inflation beginning in 2010).

Section 8 Moderate Rehabilitation Assistance Permitted

- A building receiving moderate rehabilitation assistance under Section 8 of the United States Housing Act of 1937 is not prohibited from being a qualified low-income building.

Extended Deadline for Satisfying Carryover Allocation 10% Test

- Taxpayers who receive a Housing Tax Credit allocation from a State Credit Agency now have one year from the date of the carryover allocation to incur

costs equal to at least 10% of the reasonably expected basis of the project.

Qualified Allocation Plan Criteria Expanded To Include Green and Historic Factors

- The mandatory selection criteria for a State Credit Agency to include in its qualified allocation plan for allocation Housing Tax Credits among projects now includes the energy efficiency and historic nature of the project.

Student Housing Prohibition Inapplicable To Students Who Received Foster Care

- A unit will not fail to be treated as a low-income unit solely due to being occupied by students who were previously under the care and placement of a State's foster care program.

Area Median Gross Income Determinations Expanded for Rural Areas

- For projects located in rural areas, income limitations will generally be based on the greater of area median gross income or national non-metropolitan median income.

Limitation on Decrease in Determination of Area Median Gross Income

- The determination of area median gross income for an affordable housing project for calendar years after 2008 will generally not decrease from the area median gross income determined for such project for the year preceding the year in which the determination is made. For projects that are subject to this HUD Hold Harmless policy for determining area median income for years 2007 and 2008, if there is an actual increase in area median income, then rents may be increased as if such Hold Harmless policy was not in effect.

Reduced Requirements for Annual Income Recertification

- Annual income recertifications generally will not be required if all units in a project are occupied by tenants who meet the income limits.

Clarification of General Public Use Requirement

- The requirement that a building be available for general public use does not prohibit the restriction of occupancy to individuals who have special needs, such as members of a specified group under a federal or state program or policy that supports housing for such group, or who are involved in artistic or literary activities.

Tax-Exempt Bonds—Bond Recycling Rules Expanded; Certain Housing Tax Credit Rules Coordinated; Federal Home Loan Bank Guarantees Temporarily Permitted

- Tax-exempt bonds used to finance affordable housing projects may be recycled (i.e. treated as refunding bonds) one time to the extent of the original principal balance of the original bonds, provided that the refunding bonds are issued within six months of the original loan repayment and not later than four years after the original bond issuance, and provided that the refunding bonds mature within 34 years after issuance. Such recycled bonds will not be deemed to be volume-cap bonds for purposes of claiming additional Housing Tax Credits.
- Certain tax-exempt bond rules regarding the determination of the status of qualified residential rental projects have been coordinated with Housing Tax Credit rules under Section 42 of the

Code. The modified rules relate to student housing, single room occupancy units, and the next available unit rule for current income determinations.

- Federal Home Loan Banks may now guarantee tax-exempt bonds through the end of 2010.

Congress Orders Study of the Act’s Impact on Housing Tax Credits

- The Comptroller General is required to submit a report to Congress by December 31, 2012 analyzing the implementation of the modifications in the Act related to Housing Tax Credits, including an analysis of the distribution of Housing Tax Credit allocations before and after the effective date of such modifications.

Gulf Opportunity Zone Modifications

- The Act removes the requirement under prior law that construction of certain self-constructed Gulf Opportunity Zone (“GO Zone”) property must have been commenced before January 1, 2008 in order to be “qualified GO Zone property” eligible for the first-year 50% bonus depreciation allowance. The Act did not modify any other requirements under prior law regarding eligibility for GO Zone first-year bonus depreciation for self-constructed property, including the placed-in-service deadline of January 1, 2010.
- The Act retroactively extends the GO Zone to include two counties in Alabama (Colbert County and Dallas County) for purposes of applying the more lenient tax-exempt bond rules applicable to bonds used to finance the construction or rehabilitation of certain property located in the GO Zone.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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¹ P.L. 110-289, signed by President Bush on July 30, 2008.

² See Joint Committee on Taxation, Technical Explanation of Division C of H.R. 3221 (JCX-63-08), July 23, 2008.