



December 17, 2020

Internal Revenue Service  
Attn: CC:PA:LPD:PR (Reg-119890-18)  
Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

**RE: Comments on Reg-119890-18 Regarding Low Income Housing Tax Credit Average Income Test Regulations**

To Whom It May Concern:

The National Council of State Housing Agencies (NCSHA) appreciates the opportunity to provide comments on the Internal Revenue Service (IRS) notice of proposed rulemaking to establish regulatory guidance on the Low Income Housing Tax Credit (Housing Credit) Average Income Test (AIT) minimum set-aside, including modifications of §1.42-15 for the Next Available Unit rule and development of a new regulation at §1.42-19 for the AIT.

NCSHA represents the nation's state Housing Credit allocating agencies, as well as the allocating agencies of the District of Columbia, New York City, Puerto Rico, the U.S. Virgin Islands, Guam, and Northern Marianas Islands.<sup>1</sup> NCSHA and our allocating agency members deeply value our longstanding partnership with IRS in the administration of the Housing Credit program.

The AIT, enacted in the Consolidated Appropriations Act of 2018, had long been one of NCSHA's top legislative priorities for the Housing Credit. We worked closely with the congressional sponsors of the Affordable Housing Credit Improvement Act, the original legislation that included the AIT, to develop the concept and draft the legislative language enacting it. In doing so, NCSHA and our congressional champions shared the goals of creating a mechanism by which to broaden the reach of the Housing Credit to more low-income households, make Housing Credit properties more affordable to very low- and extremely low-income

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<sup>1</sup> NCSHA is a nonprofit, nonpartisan organization. None of NCSHA's activities related to federal legislation or regulation are funded by organizations that are prohibited by law from engaging in lobbying or related activities.

households who do not receive rental assistance, and make more rural Housing Credit developments feasible.

While we share the IRS's commitment to maintaining property average incomes at no more than 60 percent, we have grave concerns about the policy the Service proposes for doing so in this proposed rule. We believe the policy goes beyond what is called for in the tax code and creates an excessive and unnecessary level of risk that investors and developers will be reluctant to assume. Moreover, the proposed rule's prohibition against modification of unit designations not only makes practical implementation of the AIT next to impossible, especially for properties financed with multiple subsidies and/or those with rental assistance contracts, but also creates potential conflict with federal laws such as the Fair Housing Act, the Violence Against Women Act, and §504 of the Rehabilitation Act of 1973.

We had hoped that guidance from the IRS would create a greater level of comfort in the AIT for investors and other stakeholders; thereby allowing the new minimum set-aside to achieve the goals we and our congressional champions had from the start. However, we fear the proposed rule as written has the opposite effect and will chill development of AIT properties. In the end, it is the low-income residents of Housing Credit properties who will lose out if the AIT cannot be implemented.

### **An Unnecessarily High Minimum Set-Aside Standard**

The proposed rule requires all low-income units in a project to average no more than 60 percent of area median income (AMI) as a condition of meeting the AIT minimum set-aside. Thus, even a single noncompliant unit could result in a violation of the minimum set-aside if the loss of that unit causes the overall average to go above 60 percent of AMI. Violating the minimum set-aside is the most extreme version of noncompliance because it results in the loss of all credits on the property until the minimum set-aside is restored (or ever, if the violation occurs during the first year of the credit period), not just loss of credits associated with the noncompliant unit(s).

#### Inconsistency with §42

A minimum set-aside should always be a minimum. As such, the statute at §42(g)(1)(C)(i), requires only that "40 percent... of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer with respect to the respective unit" to achieve the minimum set-aside requirements. The statute also sets forth a separate Average Test stating, "The average of the imputed income limitations designated under subclause (I) shall not exceed 60 percent of the area median gross income."

In contrast, the proposed rule requires that all low-income units average 60 percent or less in order to meet the minimum set-aside. The consequence of not achieving that average is

loss of all credits on the property for at least a period of time, not only the loss of the credits associated with the noncompliant unit(s).

NCSHA believes that inability to meet the Average Test should be considered noncompliance of the individual unit(s) in question, not a violation of the minimum set-aside, unless the noncompliance is so extreme that fewer than 40 percent of the units meet a 60 percent average. The penalty for noncompliance—potential loss of credits and/or recapture on a specific unit(s)—is sufficient to encourage compliance with the Average Test.

### Impact on investor interest

The unnecessary and excessive risk the proposed rule creates is likely to significantly reduce investor interest in AIT properties. Unless taxpayers are willing to invest in AIT properties, the AIT will not be a successful addition to the Housing Credit program, and residents will not benefit from it.

We have heard from numerous Housing Credit investors that they would be very unlikely to invest in AIT properties in the future if IRS does not change its approach to the minimum set-aside because they view AIT properties to be far riskier than properties that opt for either the 40 at 60 or 20 at 50 minimum set-asides. NCSHA has also heard from developers that they will no longer choose the AIT minimum set-aside.

While we have always expected that developers would build some “cushion” into their average (ensuring their properties have an average at some percentage below the 60 percent maximum), the increased risk inherent in the proposed rule means that developers would need to make that cushion larger than they would otherwise to counter the risk. The larger the cushion, the lower the property’s cashflow, making the property’s long-term viability more tenuous. Moreover, smaller developments, such as those in rural areas, would need a far larger cushion than larger developments, as a single unit makes up a greater proportion of the units in a small property.

### Inconsistency with the other minimum set-asides

The treatment of the AIT in the proposed rule is inconsistent with that of the other two primary minimum set-aside options.<sup>2</sup> For example, if a unit is out of compliance in a 40 at 60 development, so long as 40 percent of the units in the development are in compliance, the project does not fail the minimum set-aside; whereas under the proposed rule, a single unit out of compliance in an AIT property could jeopardize the minimum set-aside, even if 40 percent of the low-income units still have an average of 60 percent or less.

The example below compares a 10-unit property with an AIT election averaging 59 percent to a 10-unit property with a 40 at 60 election.

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<sup>2</sup> In addition to the 40 at 60, 20 at 50, and AIT minimum set-asides, New York City also has a 25 at 60 minimum set-aside option

AIT Property	
Unit Number	Income Designation
Unit 1	30
Unit 2	40
Unit 3	40
Unit 4	60
Unit 5	60
Unit 6	60
Unit 7	60
Unit 8	80
Unit 9	80
Unit 10	80

40 at 60 Property	
Unit Number	Income Designation
Unit 1	60
Unit 2	60
Unit 3	60
Unit 4	60
Unit 5	60
Unit 6	60
Unit 7	60
Unit 8	60
Unit 9	60
Unit 10	60

In the AIT example, if Unit 1 goes out of compliance, the project's average goes to 62.2 percent. Because of the proposed rule's approach, noncompliance in this one unit is a violation of the minimum set-aside, and the taxpayer may not take any credits on the entire project until the minimum set-aside is restored. This is the case even though 40 percent of the units have an average of 60 percent or less (for example, Units 4, 5, 6, and 7 constitute 40 percent of the units in the project and have an average of 60 percent).

In the 40 at 60 example, if Unit 1 goes out of compliance, the property still meets the minimum set-aside because at least 40 percent of the units are low-income units. Thus, the penalty is limited to potential loss of credits and/or recapture on the noncompliant unit, not the loss of all credits.

Mitigating actions for correcting a minimum set-aside violation

In recognition of the extreme risk created by the approach IRS takes in the proposed rule, the Service offers two mitigating actions a taxpayer could take to prevent a minimum set-aside violation in a case when noncompliance would cause the average of a development to go above 60 percent.

If a property has market-rate units in it, the owner could convert one or more market-rate units to low-income units to reestablish the average, but only if the market-rate unit(s) is vacant or occupied by an otherwise eligible tenant. As the vast majority of Housing Credit properties are 100 percent low-income properties, this mitigation action is limited in applicability.

The other option is for the owner to remove a unit from the credit calculation. As explained later in this comment letter, we believe there are practical limitations to and process questions regarding removing a unit which may complicate this option.

Regardless of which mitigating action an owner takes, the proposed rule provides a taxpayer up to 60 days after the end of the calendar year in which a violation occurred to take a mitigating action in order to avoid having the violation result in loss of credits. While we appreciate IRS's attempt to provide this safe harbor, unfortunately, it does not resolve the extreme and disproportionate risk of investing in an AIT property.

It is likely that the owner may not know there is a violation of the average until well after the mitigation period is over, depending on when the violation occurs and when the state agency's compliance monitoring is scheduled for that property. Even the most rigorous internal auditing and other due diligence measures on the part of an owner or syndicator may not discover noncompliance until after the mitigation period.

*Mitigation Timing Example: A unit is out of compliance in 2021. The owner has until 60 days into 2022 to fix the issue. However, the state agency is not scheduled to inspect the property until after that mitigation period ends, and the owner does not realize the unit is out of compliance until the state discovers it. Thus, the owner does not have the ability to prevent the violation from resulting in a loss of credits.*

### Casualty loss in AIT properties

The AIT proposed rule exacerbates another concern NCSHA previously has raised with IRS about its policies related to casualty loss. When a casualty loss occurs, with the exception of cases in which the casualty is in relation to a major disaster declaration, the owner only has until the end of the calendar year to restore the damage to the impacted buildings. This policy can be problematic depending on the timing of the casualty and the extent of the damage. The AIT proposed rule would create a new level of risk because a noncompliant unit could create a violation of the minimum set-aside.

As noted above, the mitigating action most likely available to an owner in such a circumstance would be to remove a higher income unit from the credit calculation. This is an especially unreasonable penalty in cases when noncompliance is caused by a casualty loss. In these instances, the noncompliance is beyond the control of the owner and did not result from any negligent action.

*Casualty Loss Example: A fire occurs in a unit in December. The owner is not able to restore the unit by the end of the calendar year, and the loss of that unit causes the project's average to go above 60 percent of AMI. In order to not violate the minimum set-aside (assuming the mitigating action of converting a market rate unit to a low-income unit is not available, as would be the case in most instances) the owner would need to remove an otherwise compliant higher income unit from the credit calculation to reestablish the average.*

### **Inability to Modify Income Designations**

By prohibiting the taxpayer from changing the designated imputed income limitation of individual units once made, the proposed rule not only stymies practical implementation of AIT, but also sets up the potential for conflicts with the Fair Housing Act, §504 of the Rehabilitation Act of 1973, and the Violence Against Women Act (VAWA). Any conflict with these federal laws could lead to litigation, creating liabilities for state agencies and property owners.

NCSHA strongly believes that, for the benefit of tenants, owners should be able to modify unit designations, so long as the applicable state agency allows for such designation changes in its policies and approves of the changes the owner would like to make. Changing unit designations should be considered a mitigating action to correct noncompliance. Indeed, it is the most important mitigating action IRS could allow.

#### Inconsistencies with §42 and other IRS policies

§42 does not prohibit modification of income designations, and there is no indication that it was Congress's intent to do so. In fact, the Consolidated Appropriations Act of 2018, which enacted the AIT, modified the next available unit rule in §42(g)(2)(D) with the expectation that, at least in projects that have market-rate units, an owner would need to be able to modify income designations to address over-income tenants.

Moreover, the proposed rule, in keeping with §42(g)(2)(D), modifies the existing regulations at §1.42-15 relating to the next available unit rule. However, the proposed change to §1.42-15 contradicts the proposed new regulation at §1.42-19, as §1.42-15 allows for modifications of income designation, whereas §1.42-19 prohibits such modifications.

The proposed rule is also at odds with long-standing IRS policy with respect to transfers of households between units within a project. IRS Revenue Procedure 2004-82 in Section E. Vacant Unit Rule Issues, in answer to question #8, established that the low-income qualified status of a unit moves with a qualified household if the household transfers from one unit to another. In contrast, the AIT proposed rule would lock the qualifying designations down by unit far more rigorously, and would make management and compliance relating to transfers for AIT projects far less flexible than is allowed for the other minimum set-asides. The flexibility allowed in this policy has always provided a safe harbor for compliance at Housing Credit properties with other relevant housing laws and regulations.

#### Conflicts with federal laws on fair housing, accessibility and violence against women

In certain circumstances, the proposed rule may create conflicts with the Fair Housing Act because it could prevent an owner from making a reasonable accommodation upon request of a tenant with a disability. Specifically, the Fair Housing Act makes it unlawful for any person to refuse "to make reasonable accommodations in rules, policies, practices, or services when

such accommodation may be necessary to afford... person(s) [with disabilities] equal opportunity to use and enjoy a dwelling.”<sup>3</sup>

*Fair Housing Example: A household with an income of 55 percent of AMI lives in a 60 percent-designated unit on the third floor of an AIT development. A member of the household becomes disabled and needs a first-floor unit because they are unable to climb stairs. A first-floor unit in the project is available, but the unit is a 40 percent-designated unit. The proposed rule prohibits the owner from switching income designations of the units, thus the owner cannot meet the reasonable accommodation request allowing the household to move to the first-floor unit while maintaining compliance with Housing Credit regulations.*

The proposed rule may also create conflicts with §504 of the Rehabilitation Act of 1973 and numerous state laws which provide accessibility protections for persons with disabilities. While §504 does not directly apply to the Housing Credit, it does apply to federally subsidized housing. The vast majority of Housing Credit properties either have some sort of federal subsidy in the capital stack and/or a rental assistance contract.

In the case of §504-related properties, persons who need the features of such units have statutory priority on waitlists for transfers and new move-ins. State agencies may require other properties to implement similar policies in keeping with the intent of producing more accessible units, as a requirement for a Housing Credit allocation.

Additionally, if a household lives in a §504-compliant unit and does not need the accessible features of that unit, they must agree to transfer to an appropriate unit if a household that does need the features of the unit applies. The proposed policy would limit the ability to allow these sorts of transfers.

*§504 Example: A household that needs the features of an accessible unit applies for housing. There is an accessible unit available that is designated as a 40 percent unit. The household qualifies under the 50 percent limit but not 40 percent. Under the proposed rule, the household would be denied housing based on the fixed designation, even if the change in designation would not cause the overall property average to exceed 60 percent of AMI.*

*§504 Example: A household applies for housing and needs the features of an accessible unit. There is an accessible unit that is designated as a 40 percent unit and the household qualifies under the 40 percent limit. However, that unit is currently occupied by another resident who does not need the accessibility features and thus has agreed to a unit transfer if necessary. However, the only unit available that the nondisabled household can transfer to is a 30 percent-designated unit, but that household does not qualify for that unit. The transfer cannot occur because of the fixed designation, and the household needing the features of the unit is not housed.*

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<sup>3</sup> 42 U.S.C. §3604(f)(3)(B).

In certain circumstances, the proposed rule may create conflicts with VAWA. Since the reauthorization of VAWA in 2013, the Housing Credit has been a covered program for purposes of the law. VAWA provides that victims/survivors of domestic violence, dating violence, sexual assault, or stalking may request an emergency transfer to a different unit or property if the person reasonably believes there is a threat of imminent harm from further violence if they remain in their unit or if a sexual assault occurred on the premises 90 days before the transfer request is made.<sup>4</sup> A Housing Credit owner may not be able to accommodate an emergency transfer request if they are unable to modify unit designations. Not adhering to VAWA at a property covered by the VAWA statute can also be determined by HUD's Office of Fair Housing and Equal Opportunity (FHEO) to be a violation of the Fair Housing Act, under HUD FHEO's disparate impact policy.<sup>5</sup>

*VAWA Example: A domestic violence survivor living in a 30 percent-designated unit requests an emergency transfer to a unit in another building in the property for their protection. The only other unit available is an 80 percent-designated unit, which would be unaffordable to the household. Because the proposed rule prohibits the owner from modifying unit designations, the owner is unable to meet the emergency transfer request and maintain compliance with Housing Credit regulations, while also maintaining affordability for the household.*

#### Conflicts with other federal housing programs

Throughout §42 and IRS guidance, Congress and the IRS have always made great efforts to allow the combination of other federal programs with the Housing Credit. However, the AIT proposed rule will create significant challenges for properties that are financed with other federal subsidies in addition to Housing Credit equity, making combining subsidies impractical.

Nearly every other major federal housing program has statutory or programmatic rules that require or allow the floating of units or modification of income designation in certain circumstances. These notably include Public Housing, Project-Based Section 8, the HOME Investment Partnerships (HOME) program, the Housing Trust Fund, and U.S. Department of Agriculture Rural Development programs. Fixing the AIT designations would not work with these programs for various reasons and, thus disqualifies the AIT minimum set-aside from the majority of Housing Credit properties. According to NCSHA's 2019 Factbook, only 12.8 percent of Housing Credit units financed in 2019 were financed without other federal sources. This is relatively consistent year over year.

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<sup>4</sup> 42 U.S.C. §14043e-11

<sup>5</sup> February 9, 2011 MEMORANDUM FOR FHEO Office Directors and FHEO Regional Directors. Assessing Claims of Housing Discrimination against Victims of Domestic Violence under the Fair Housing Act and the Violence Against Women Act.



One of the primary benefits envisioned in the creation of the AIT was the ability to better align the Housing Credit with other programs that have income limitations up to 80 percent of AMI to make the Housing Credit a better tool for preserving federally subsidized housing. This includes housing originally financed using public housing, Section 8, and Rural Development programs. In all of these cases, the AIT, would allow the Housing Credit to be used for preservation while significantly limiting the displacement of households whose incomes fall between 60 and 80 percent of AMI. The proposed rule, by barring unit designation modifications, makes preservation of these properties using AIT impractical.

*Public Housing Example: The Housing Credit is used to preserve a property in which some units also receive public housing operating subsidy funds to ensure that households are not rent burdened (public housing does not have a rent subsidy, but operating subsidy funds serve the same purpose). A household moves into one of the public housing units, which is income designated at 40 percent of AMI for purposes of the Housing Credit program. However, at recertification (required under public housing), the household's income has increased to above 40 percent of AMI, causing income-based rents to rise for purposes of public housing. This creates a conflict between the public housing rules and the Housing Credit rules, as public housing requires that the tenant paid portion of rent and the utility allowance exceed the level allowable under the Housing Credit for a 40 percent-designated unit. The owner is unable to adjust the unit designation, thus cannot be compliant with both programs.*

*HOME Example: A HOME/Housing Credit project has a tenant who moves into a 50 percent-designated unit (referred to under HOME as a "low HOME" unit). At annual tenant recertification required by the HOME program, the household's income exceeds the 50 percent income limitations. HOME rules require that another comparable unit be re-designated as "low-HOME" and the unit rented by the household with increased ability to pay rent be turned into a "high HOME" unit, which has a rent appropriate to the 60 percent AIT designation. This rent increase would disqualify the household for a 50 percent-designated unit. Thus, if adjustment of the unit designation for purposes of the AIT is not allowed, AIT projects will not be able to use HOME as part of the capital stack.*

*Housing Trust Fund (HTF) Example: A 50-unit Housing Credit project electing AIT has 5 floating HTF units in it. HTF regulations require annual recertification of tenants in HTF properties. If a tenant's income increases such that they are no longer an extremely low-income (ELI) household, the owner must make the next available unit an HTF unit, with the appropriate income and rent restrictions. The next available unit is an 80 percent-designated unit and there has been a household on the waiting list in need of such a unit. However, the owner must skip over that household and instead rent the unit to an ELI household who has not been on the waiting list as long. Subsequently, the next available unit is a 40 percent-designated unit, continuing to exclude the waiting household because of the fixed designations. Moreover, the property was underwritten expecting the rent from the 80 percent unit, which is now treated as a 30 percent unit in practice to comply with the HTF program. Because the owner cannot redesignate other units to make up the*

*loss in rent, the property eventually becomes a troubled property because its debt-to-income ratio is in the red.*

*Project-Based Section 8 Example: Under project-based Section 8 income targeting requirements, 30 percent of all new move-ins every year must not exceed the current HUD ELI limitation. To meet this requirement, owners typically require move-ins that happen early in the year to be ELI households and make adjustment to which households they move in throughout the year if there are either more or fewer move-ins than the owner estimated they would have for the year. In this example, units designated at 70 percent and 80 percent for AIT purposes become available early in the year. In order to ensure compliance with Section 8, the owner moves in two ELI households, thus essentially treating those units as 30 percent units, even though they are technically 70 percent and 80 percent units. Later in the year after the owner believes they have met their new move-in requirements for Section 8, two 30 percent-designated units become available. Because the AIT regulations do not allow the owner to modify unit designations, the owner is unable to serve households at 70 percent and 80 percent of AMI who have been on the waiting list. Because of the complications caused by complying with the rules for both programs, Section 8 owners are unlikely to take advantage of the AIT election.*

*Project-Based Section 8 Example: The Housing Credit is used to fund the acquisition and rehabilitation of an existing Section 8 property. Of the 100 occupied units, the incomes of 6 households exceed 60 percent of AMI, but these households would qualify for 70 percent- or 80 percent-designated units. Because fixed designations do not work with Section 8 (see above example), the owner selects the 40-60 minimum set-aside when they would have selected the AIT prior to the proposed rule. These households must either be displaced or the owner will not be able to take credits on their units.*

*Rural Development Example: Rural Development waitlist requirements group applicants first by income category and then by date of application when selecting tenants for each available unit. As Rural Development allows households earning up to 80 percent of AMI as one of their income categories, it would appear that AIT would work very well with these projects. However, as there will be no way to determine which fixed AIT designation is attached to the next available unit, the owner cannot coordinate the Rural Development waitlist requirement with the AIT fixed designation requirement. Thus, the owner cannot elect the AIT.*

### Conflicts with existing state policies

State Housing Credit Agencies are very experienced with allowing units to float while adhering to developer commitments for units designated at various income tiers. Long before the AIT became law, many states had policies that promoted income tiering at various levels below 60 percent of AMI. Thus, properties with a 40 at 60 minimum set-aside election have units designated at different income levels. These policies typically, if not always, allow for those units to float. In fact, state agencies have built or purchased software allowing them to track

floating units. Not only has this policy not been problematic, but it has facilitated the success of income tiering.

When the AIT was enacted into law nearly three years ago, it was immediately made an eligible minimum set-aside election option for project sponsors. Without knowing when or if the IRS would provide guidance, most state agencies established their own AIT policies, with the assumption that if IRS were to provide guidance, that guidance would be reasonable and seek to facilitate use of the AIT. State agencies never expected IRS would bar unit designation changes. To our knowledge, not a single state Housing Credit Agency that has implemented AIT policies up until this point has prohibited redesignation of units. In fact, in some instances, AIT projects' extended use agreements specifically state that the units may float.

In some cases, state agencies include in their policies requirements that owners recertify incomes for households in AIT properties (even if the properties are 100 percent low-income properties and thus recertification is not required by the IRS) for the express purpose of modifying a unit's income designation if incomes of the tenants change significantly. This can allow states and owners to help tenants maintain affordability if their incomes decrease, while also ensuring that a household that gets a large increase in income is not taking up a unit that could otherwise be rented to a lower income tenant.

*State Policy Example: A tenant living in a 30 percent-designated unit gets a new job and is earning 70 percent of AMI. Another tenant has an income below 30 percent of AMI, but when the tenant moved in, the only unit available to them was a 70 percent unit, and they are rent burdened. The state previously would have allowed the owner to swap the income designations of those units upon lease renewal so that the tenant who now has an income of 70 percent of AMI is not in a 30-percent designated unit and the lower-income tenant could have a unit affordable to them. This is not possible under the proposed rule.*

*State Policy Example: A tenant in a 70 percent-designated unit has a loss of income, but has been a model tenant and the owner would like to lower their unit's income designation so that the tenant can remain in their unit and pay a lower rent. The owner would then rent the next available unit at a higher level to make up the difference. This is not possible under the proposed rule.*

Furthermore, some states envisioned income redesignation as a key way to help owners maintain compliance with the statute's Average Test. Noncompliance is typically accidental and can happen to even the most experienced owners or property managers. As IRS considers allowing mitigating actions to help owners reestablish the overall property average in cases of noncompliance, it should consider modifications to unit designations as the most important tool by which to do so.

*State Policy Example: A 30 percent-designated unit is leased to a household. During an internal audit or state agency review, a calculation error is discovered and the household is determined to be over the 30 percent limit but well below the 40 percent limit. The owner*

*must require the household to vacate the unit and move into a unit with a higher designation, assuming a comparable one is available. If the owner has no higher units available that are of eligible bedroom size, the owner would need to move the household out of the property.*

#### Other practical limitations to implementation without the ability to redesignate units

The prohibition against redesignating units creates many other challenges for practical implementation of AIT, including challenges related to casualty loss and managing waitlists.

The proposed rule could make it harder to meet the needs of existing tenants in cases of casualty loss. If a household living in a damaged unit is not income eligible for a vacant undamaged unit, the owner would not be able to temporarily move the household to the vacant unit while they repair the tenant's original unit.

*Casualty Loss Example: A pipe bursts creating water damage to a 50 percent-designated unit. A 30 percent-designated unit is vacant, but the household living in the 50 percent-designated unit does not qualify. The owner is unable to temporarily move the household out of the unit that suffered the casualty to the 30 percent-designated unit while the damage is repaired.*

The proposed rule's prohibition against changing unit designations would create challenges for assisting households on the waiting list for a property and would prevent an owner from reestablishing compliance should a unit be out of compliance due to a mistake in a tenant's income calculation.

#### **Tracking Removed Units for Credit Calculation Purposes**

As noted above, if a unit is out of compliance causing the project average to exceed 60 percent of AMI, the proposed rule would allow owners up to 60 days to take a mitigating action in order to avoid a minimum set-aside violation. The proposed rule provides that an owner may remove a unit from the Credit calculation as a mitigating action in order to reestablish a 60 percent or lower average. However, it is not clear who is responsible for keeping track of whether the taxpayer removes units from its credit calculation to reestablish compliance.

State agencies are responsible for reporting noncompliance and when that noncompliance has been corrected; but it is the jurisdiction of the IRS to determine the penalty for noncompliance, including whether that noncompliance results in loss of Credits. It is not clear if IRS expects state agencies to ensure that a taxpayer addresses noncompliance by removing a unit from its credit calculation. If so, this would be an inappropriate role for the state, as taxpayer return information is protected by §6103 of the tax code.

Assuming that IRS will remain the responsible entity in determining the applicable credit amount a taxpayer may claim, IRS would need to cross reference the Form 8823 submissions from the state agency against a taxpayer's tax forms to ensure that removed units are reflected in the amount of credit the taxpayer claims. The practical use of this mitigating action option will depend on IRS's ability to do this.

### **NCSHA's Recommendations for the Final Rule**

In light of the concerns NCSHA has highlighted in this letter, we recommend IRS make the following changes when it issues the AIT final rule.

1. The AIT minimum set-aside should be considered met so long as 40 percent of the units in the property have an average of 60 percent or less of AMI. In addition, the property should have to meet an overall Average Test of no more than 60 percent of AMI across all low-income units. If a unit is out of compliance causing the property-wide average to go above 60 percent of AMI, this should be considered noncompliance for that unit, but not a violation of the minimum set-aside, so long as 40 percent of the units still meet the 60 percent average.

We believe this solution is consistent with a literal reading of the tax code and congressional intent, while also providing sufficient penalty for noncompliance without creating excessive and unnecessary risk that will negate investor interest.

2. The final rule should allow owners to modify unit designations, so long as the state Agency allows for that in its policies and the state Agency consents to the change. Unit designation changes should always be allowed if needed to adhere to the Fair Housing Act, VAWA, §504 of the Rehabilitation Act of 1973, or any other relevant federal or state statute.

States should be able to allow either of these types of modifications to unit designations:

- Floating units in which the overall property average does not change. For example, Unit 1A, previously a 40 percent-designated unit, can become an 80 percent-designated unit if Unit 2A, previously an 80 percent-designated unit, becomes a 40 percent-designated unit.
- Modifying individual unit designations even if it changes the average in the property, so long as the average remains below 60 percent of AMI. For example, Unit 1A was previously a 40 percent-designated unit in a property that averaged 56 percent. Unit 1A becomes a 50 percent-designated unit, raising the property average to 58 percent.

If IRS does not modify its policy on the standard for violation of the minimum set-aside, it should at least modify the time period provided for taking mitigating actions. State Housing Credit Agencies should be able to set a reasonable time period for taxpayers to take the necessary mitigating actions, and that time period should not start until the state identifies the noncompliance. Moreover, if IRS does not make substantial changes to this policy, the rule must provide an exception when noncompliance results from a casualty loss.

However, even if IRS modifies the mitigation period and shows leniency in cases of casualty loss, it may not be enough to engender interest in AIT from investors and could be significantly problematic for AIT properties currently in the pipeline or that have already placed in service. Thus, if the proposed rule is made final without the changes NCSHA suggests, IRS should provide owners of AIT properties an opportunity and a reasonable period under the circumstances to choose a different minimum set-aside and grandfather existing residents who have been allowed occupancy in good faith in accordance with the statute and state Agency policies without reduction in qualified basis.

We appreciate your consideration of our comments. NCSHA respectfully requests that IRS provide the option to further discuss the issues we have raised in this comment letter at a public hearing on the AIT proposed rule.

Please do not hesitate to reach out to me if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Garth Rieman", with a long horizontal flourish extending to the right.

Garth Rieman  
Director of Housing Advocacy and Strategic Initiatives