

**DESCRIPTION OF THE
“KATRINA HOUSING TAX RELIEF ACT OF 2007”**

Scheduled for Markup
By the
HOUSE COMMITTEE ON WAYS AND MEANS
on March 21, 2007

Prepared by the Staff
of the
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INTRODUCTION

The House Committee on Ways & Means has scheduled a markup on March 21, 2007. This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the “Katrina Housing Tax Relief Act of 2007.”

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of the “Katrina Housing Tax Relief Act of 2007”* (JCX-12-07), March 19, 2007.

A. Extension and Expansion of Low-Income Housing Credit Rules for Buildings in the GO Zones

Present Law

In general

The low-income housing credit may be claimed over a 10-year period for the cost of rental housing occupied by tenants having incomes below specified levels. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The qualified basis of any qualified low-income building for any taxable year equals the applicable fraction of the eligible basis of the building.

The credit percentage for newly constructed or substantially rehabilitated housing that is not Federally subsidized is adjusted monthly by the Internal Revenue Service so that the 10 annual installments have a present value of 70 percent of the total qualified basis. The credit percentage for newly constructed or substantially rehabilitated housing that is Federally subsidized and for existing housing that is substantially rehabilitated is calculated to have a present value of 30 percent of qualified basis. These are referred to as the 70-percent credit and 30-percent credit, respectively.

Credit cap

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. Generally, the aggregate credit authority provided annually to each State for calendar year 2006 is \$1.90 per resident with a minimum annual cap of \$2,180,000 for certain small population States. These amounts are indexed for inflation. These limits do not apply in the case of projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit.

Under the Gulf Opportunity Zone Act of 2005, the otherwise applicable housing credit ceiling amount is increased for each of the States within the Gulf Opportunity Zone (Alabama, Louisiana, and Mississippi). This increase applies to calendar years 2006, 2007, and 2008. The additional credit cap for each of the affected States equals \$18.00 times the number of such State's residents within the Gulf Opportunity Zone. This amount is not adjusted for inflation. For purposes of this additional credit cap amount, the determination of population for any calendar year is made on the basis of the most recent census estimate of the resident population of the State in the Gulf Opportunity Zone released by the Bureau of the Census before August 28, 2005. In addition, under the Gulf Opportunity Zone Act of 2005, the otherwise applicable housing credit ceiling amount is increased for Florida and Texas by \$3,500,000 per State. This increase only applies to calendar year 2006.

Carryover allocation rule

A low-income housing credit is allowable only if the owner of a qualified building receives a housing credit allocation from the State or local housing credit agency. In general, the allocation must be made not later than the close of the calendar year in which the building is

placed in service. One exception to this rule is a carryover allocation. In a carryover allocation, an allocation may be made to a building that has not yet been placed in service, provided that: (1) more than ten percent of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation) is incurred as of the later of six months after the allocation is made or the end of the calendar year in which the allocation is made; and (2) the building is placed in service not later than the close of the second calendar year following the calendar year of the allocation.

Enhanced credit

Generally, buildings located in high cost areas (i.e., qualified census tracts and difficult development areas) are eligible for an enhanced credit. Under the enhanced credit, the 70-percent and 30-percent credit is increased to a 91-percent and 39-percent credit, respectively. The mechanism for this increase is an increase from 100 to 130 percent of the otherwise applicable eligible basis of a new building or the rehabilitation expenditures of an existing building. A further requirement for the enhanced credit is that no more than 20 percent of the population of each metropolitan statistical area or nonmetropolitan statistical area may be a difficult to develop area.

Under the Gulf Opportunity Zone Act of 2005, the Gulf Opportunity Zone, the Rita GO Zone, and the Wilma GO Zone are treated as high-cost areas for purposes of the low income housing credit for property placed-in-service in calendar years 2006, 2007, and 2008. Therefore, buildings located in the Gulf Opportunity Zone, the Rita Go Zone, and the Wilma GO Zone are eligible for the enhanced credit. Under the enhanced credit, the 70-percent and 30-percent credits are increased to 91-percent and 39-percent credits, respectively. The 20-percent of population restriction is waived for this purpose. This enhanced credit applies regardless of whether the building receives its credit allocation under the otherwise applicable low-income housing credit cap or the additional credit cap. The provision to treat the Gulf Opportunity Zone, Rita GO Zone and the Wilma GO Zone as a high-cost area is generally effective for calendar years beginning after 2005 and before 2009, and buildings placed-in-service during such period in the case of projects that also receive financing with the proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued after December 31, 2005.

Definition of Federally subsidized

In general, any newly constructed or substantially rehabilitated building is treated as Federally subsidized for any taxable year if, at any time during such taxable year or prior taxable year, there is or was outstanding any obligation the interest of which is exempt under section 103, or any below market Federal loan, the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof. Exceptions are provided from this general rule; (1) if the taxpayer elects to reduce eligible basis; and (2) for certain subsidized construction financing. For purposes of this rule, a below market Federal loan generally is defined as a loan funded in whole or in part with Federal funds if the interest payable on such loan is less than the applicable Federal rate in effect under section 1274(d)(1) (as of the date the loan was made). A loan is not treated as a below market Federal loan for these purpose, if it is below market solely by reason of assistance provided under section 106, 107, or 108 of the

Housing and Community Development Act of 1974 as in effect on December 19, 1989 (the date of enactment of the Omnibus Budget Reconciliation Act of 1989).

Description of Proposal

Carryover allocation rule

The provision makes two modifications to the carryover allocation rule for otherwise qualifying buildings located in the Gulf Opportunity Zone, the Rita GO Zone and the Wilma GO Zone placed in service before January 1, 2011. First, it repeals the requirement that 10 percent of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation) must be incurred as of the later of six months after the allocation is made or the end of the calendar year in which the allocation is made (the "10-percent rule"). Second, it repeals the requirement that such building be placed in service not later than the close of the second calendar year following the calendar year of the allocation (the "second-year placed in service rule"). These changes apply only to allocations made in 2006, 2007, or 2008. Therefore, an otherwise qualifying building is treated as a qualifying for the credit regardless of whether the 10-percent rule or the second-year placed in service rule are satisfied if such building: (1) receives an allocation in 2006, 2007, or 2008; and (2) is placed in service before January 1, 2011, in one of the GO Zones.

Enhanced credit

The provision extends the enhanced credit available under the Gulf Zone Opportunity Act of 2005 for two additional years (2009 and 2010). This provision to treat the Gulf Opportunity Zone, Rita GO Zone and the Wilma GO Zone as a high-cost area is generally effective for calendar years beginning after December 31, 2008 and before January 1, 2011, and for buildings placed-in-service during such period in the case of projects that also receive financing with the proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued during that period. Therefore, otherwise qualifying buildings located in the Gulf Opportunity Zone, the Rita GO Zone, and the Wilma GO Zone generally are eligible for the enhanced credit if placed in service after 2005 and before 2011.

Definition of Federally subsidized

The provision modifies the definition of below market Federal loan for otherwise qualifying buildings located in the Gulf Opportunity Zone, the Rita GO Zone and the Wilma GO Zone that are placed in service during the period beginning on January 1, 2006 and ending on December 31, 2010. Under the provision, a loan is not treated as a below market Federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 by reason of: (1) section 122 of that Act; (2) any provision of the Department of Defense Appropriations Act, 2006 (Pub. L. No. 109-141); or (3) the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006 (Pub. L. No. 109-234). Therefore, such assistance will not cause an otherwise qualifying building receiving such assistance to be treated as Federally subsidized for purposes of the credit.

Effective Date

The provisions are effective upon enactment.

B. Special Tax-Exempt Bond Financing Rule for Repairs and Reconstructions of Residences in the Go Zones

Present Law

In general

Under present law, gross income does not include interest on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes (“qualified private activity bonds”). The definition of a qualified private activity bond includes a qualified mortgage bond.

Qualified mortgage bonds

Qualified mortgage bonds are tax-exempt bonds issued to make mortgage loans to eligible mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences. The Code imposes several limitations on qualified mortgage bonds, including income limitations for eligible mortgagors, purchase price limitations on the home financed with bond proceeds, and a “first-time homebuyer” requirement. In addition, bond proceeds generally only can be used for new mortgages, i.e., proceeds cannot be used to acquire or replace existing mortgages.

Exceptions to the new mortgage requirement are provided for the replacement of construction period loans, bridge loans, and other similar temporary initial financing. In addition, qualified rehabilitation loans may be used, in part, to replace existing mortgages. A qualified rehabilitation loan means certain loans for the rehabilitation of a building if there is a period of at least 20 years between the date on which the building was first used (the “20 year rule”) and the date on which the physical work on such rehabilitation begins and the existing walls and basis requirements are met. The existing walls requirement for a rehabilitated building is met if 50 percent or more of the existing external walls are retained in place as external walls, 75 percent or more of the existing external walls are retained in place as internal or external walls, and 75 percent or more of the existing internal structural framework is retained in place. The basis requirement is met if expenditures for rehabilitation are 25 percent or more of the mortgagor’s adjusted basis in the residence, determined as of the later of the completion of the rehabilitation or the date on which the mortgagor acquires the residence.

Qualified mortgage bonds also may be used to finance qualified home-improvement loans. Qualified home-improvement loans are defined as loans to finance alterations, repairs, and improvements on an existing residence, but only if such alterations, repairs, and improvements substantially protect or improve the basic livability or energy efficiency of the property. Qualified home-improvement loans may not exceed \$15,000, and may not be used to refinance existing mortgages.

As with most qualified private activity bonds, issuance of qualified mortgage bonds is subject to annual State volume limitations (the “State volume cap”). For calendar year 2007, the State volume cap, which is indexed for inflation, equals \$85 per resident of the State, or \$256.24 million, if greater. Exceptions from the State volume cap are provided for bonds issued for certain governmentally owned facilities (airports, ports, high-speed intercity rail, and solid waste disposal) and bonds which are subject to separate local, State, or national volume limits (public/private educational facilities, enterprise zone facility bonds, qualified green building/sustainable design projects, and qualified highway or surface freight transfer facility bonds).

Gulf Opportunity Zone Bonds

The Gulf Opportunity Zone Act of 2005 (the “Act”) authorizes Alabama, Louisiana, and Mississippi (or any political subdivision of those States) to issue qualified private activity bonds to finance the construction and rehabilitation of residential and nonresidential property located in the Gulf Opportunity Zone (“Gulf Opportunity Zone Bonds”). Gulf Opportunity Zone Bonds are not subject to the State volume cap. Rather, the maximum aggregate amount of Gulf Opportunity Zone Bonds that may be issued in any eligible State is limited to \$2,500 multiplied by the population of the respective State within the Gulf Opportunity Zone.

Gulf Opportunity Zone Bonds issued to finance residences located in the Gulf Opportunity Zone are treated as qualified mortgage bonds if the general requirements for such bonds are met. The Act also provides special rules for Gulf Opportunity Zone Bonds issued to finance residences located in the Gulf Opportunity Zone. For example, the first-time homebuyer rule is waived and the income and purchase price rules are relaxed for residences financed in the GO Zone, the Rita GO Zone, or the Wilma GO Zone. In addition, the Act increases from \$15,000 to \$150,000 the amount of a qualified home-improvement loan with respect to residences located in the specified disaster areas. Gulf Opportunity Zone Bonds must be issued before January 1, 2011.

Description of Proposal

Under the provision, a qualified GO Zone repair or reconstruction loan shall be treated as a qualified rehabilitation loan for purposes of the qualified mortgage bond rules. Thus, such loans financed with the proceeds of qualified mortgage bonds and Gulf Opportunity Zone Bonds may be used to acquire or replace existing mortgages, without regard to the existing walls rule or the 20 year rule under present law. The proposal defines a qualified GO Zone repair or reconstruction loan as any loan used to repair damage caused by Hurricane Katrina, Hurricane Rita, or Hurricane Wilma to a building located in the Gulf Opportunity Zone, the Rita GO Zone, or the Wilma GO Zone (or reconstruction of such building in the case of damage constituting destruction) if the expenditures for such repair or reconstruction are 25 percent or more of the mortgagor’s adjusted basis in the residence. For purposes of the proposal, the mortgagor’s adjusted basis shall be determined as of the completion of the repair or reconstruction or, if later, the date on which the mortgagor acquires the residence.

Effective Date

The provision applies to owner-financing provided after the date of enactment and before January 1, 2011.