Part I

Section 42.—Low-income housing credit

26 CFR 1.42–14: Allocation rules for post-2000 State housing credit ceiling amount.

Rev. Rul. 2016–29

ISSUE

When state housing credit agencies allocate housing credit dollar amounts, does § 42(m)(1)(A)(ii) of the Internal Revenue Code (Code) require or encourage these agencies to reject any proposal that does not obtain the approval of the locality where the project developer proposes to place the project?[1]

[1] Section 147(f) requires public approval for all issuances of proposed qualified private activity bonds, including bonds used to finance qualified residential rental projects. These bond issuances must be approved both (a) by the governmental unit which is to issue the bonds or on behalf of which they are to be issued (issuer approval) and (b) by a governmental unit the geographic jurisdiction of which includes the site of the facility to be financed (host approval). Although the host-approval component of public approval means approval by a governmental unit whose jurisdiction includes the site of the financed facility, "public approval" (including "host approval") does not include "local approval." To illustrate, bonds issued by (or on behalf of) a State may be approved by the State alone in its capacities as issuer and as a host governmental unit whose jurisdiction includes the site of the financed facility. So there is no requirement for local approval by the county or municipality in which the financed facility is to be located. *See* § 5f.103–2(c) of the Temporary Income Tax Regulations Under the Tax Equity and Fiscal Responsibility Act of 1982. Thus, § 42(m)(1)(A)(ii) neither requires nor encourages *local* approval for these bond-financed projects, although § 147 does require *public* approval for issuing the bonds.

FACTS

Agency, a housing credit agency in State *X,* is responsible for allocating housing credit dollar amounts to applicants that seek to develop affordable housing projects that will be eligible to earn low-income housing tax credits (LIHTCs). To guide *Agency* in making these allocations, *Agency* adopted, and the relevant governmental unit approved, a qualified allocation plan (QAP).

This QAP contains provisions that strongly favor applications from affordable housing projects that demonstrate affirmative local support. For example, under the point system that *Agency* uses in judging among applicant projects, points are granted to projects that—

- Manifest quantifiable community participation with respect to the project, especially as evidenced by written statements from neighborhood organizations in the area of the proposed project.
- Receive a commitment of development funding by the local political subdivision.
- Receive community support for the application, as evidenced by a written statement from the state legislator elected from the district in which the project is proposed to be developed.

Agency believes that § 42(m)(1)(A)(ii) requires that allocations be made only to proposals that receive the approval of the locality where the proposed project is to be located. Accordingly, *Agency* will reject an application if evidence of affirmative local support is lacking, and *Agency* uses factors such as the ones in its QAP to determine

whether or not that support exists. Requiring local approval empowers jurisdictions to exercise what some call a "local veto."

In State *X*, local approval is much more likely to be secured for proposed LIHTC developments in areas with greater proportions of minority residents and fewer economic opportunities than in higher-opportunity, non-minority communities. *Agency's* practice of requiring local approval has created a pattern of allocating housing credit dollar amounts to projects in the predominantly lower-income or minority areas, with the result of perpetuating residential racial and economic segregation in State *X*.

LAW

If a building is constructed and operated consistent with the requirements of § 42, the building's owners generally receive a 10-year stream of LIHTCs.

Under § 42(h), however, the LIHTCs determined in any year with respect to a building may not exceed the housing credit dollar amount that a State housing credit agency has allocated to the building.

Section 42(m) requires these allocations to be made pursuant to a QAP. Each QAP must contain certain preferences, and selection criteria, specified in the Code, but other factors may be added.

Section 42(m)(1)(A)(ii) prevents a housing credit dollar amount from being allocated to a building unless the allocating "agency notifies the chief executive officer (or the equivalent) of the local jurisdiction within which the building is located of such project and provides such individual a reasonable opportunity to comment on the project."

ANALYSIS

Although *Agency* believes that the local veto provisions in its QAP respond to the requirement in § 42(m)(1)(A)(ii), *Agency* misinterprets this provision. *Agency's* interpretation is inconsistent with (1) the language of § 42(m)(1)(A)(ii) and (2) general Federal fair-housing policy.

1. The Language of Section 42(m)(1)(A)(ii)

The Code requires that each local jurisdiction have a "reasonable opportunity" to comment on any proposal to allocate a housing credit dollar amount to a project within that jurisdiction. This requirement is not the same as requiring the jurisdiction's approval. The clear meaning of "reasonable opportunity to comment" is that the jurisdiction has a chance to weigh in, or even object, but not that every objection will be honored.

Thus, § 42(m)(1)(A)(ii) ensures only the opportunity for local input to the allocation decision. It does not authorize an allocating agency to abandon the responsibility to exercise its own judgment. In particular, it does not require or encourage allocating agencies to bestow veto power over LIHTC projects either on local communities or on local public officials.

2. General Federal Fair-Housing Policy

Agency's practice of requiring local approval has created a pattern of allocating housing credit dollar amounts that has perpetuated residential racial segregation in State *X*. *Agency's* practice, therefore, has a discriminatory effect based on race, which

is a protected characteristic under 42 USC 3604. Thus, the practice is inconsistent with at least the policy[2] of the Fair Housing Act of 1968 (the Act), 42 USC 3601–3619.

Nevertheless, *Agency* interprets § 42(m)(1)(A)(ii) as forcing *Agency* to require local approval, despite the discriminatory effect of that practice in State *X*. This interpretation assumes that, in creating LIHTCs, Congress silently reversed well-established, fundamental Federal fair-housing policy. Eighteen years before the 1986 enactment of § 42, the Act had firmly established this policy. *See* 42 USC 3601 ("**Declaration of policy.** It is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States."). Without legislative commentary or other persuasive evidence, one cannot conclude that Congress intended to reverse this well-established policy.

In the summer of 2015, the United States Department of Housing and Urban Development (HUD) issued new final regulations regarding obligations under the Act to Affirmatively Further Fair Housing (AFFH). *See* 80 Fed. Reg. 42272 (2015) (issuing HUD's AFFH final rule, which is codified at various locations in 24 CFR Parts 5, 91, 92, 570, 574, 576, and 903). Discussing the many decades during which AFFH had been firmly established Federal policy, HUD states in the preamble, "*From its inception [in 1968]*, the [Act] … has not only prohibited discrimination in housing related activities and transactions but has also provided, through the duty to affirmatively further fair housing … , for meaningful actions to be taken to overcome the legacy of segregation,

[2] The practice may also violate specific nondiscrimination provisions of the Act. *See Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc.,* 135 S. Ct. 2507 (2015).

unequal treatment, and historic lack of access to opportunity in housing." *Id.* at 42272 (emphasis added).

AFFH was firmly established Federal housing policy when § 42 was enacted, and there is no suggestion that Congress intended § 42 to diverge from that policy. Section 42(m)(1)(A)(ii), therefore, does not require or even encourage conduct inconsistent with that policy.

HOLDING

When state housing credit agencies allocate housing credit dollar amounts, § 42(m)(1)(A)(ii) does not require or encourage these agencies to reject all proposals that do not obtain the approval of the locality where the project developer proposes to place the project. That is, it neither requires nor encourages housing credit agencies to honor local vetoes.

DRAFTING INFORMATION

The principal author of this revenue ruling is James W. Rider of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, please contact Mr. Rider at (202) 317-4137 (not a toll-free call).

Exhibit 15