Promising Practices for Tax Initiatives That Address Sustainable Development Goals

A U.S. Case Study from the GAO Audit of the Low-Income Housing Tax Credit Program (LIHTC)
Government Accountability Office

• **Who We Are:** an independent, nonpartisan agency in the legislative branch of the federal government

• **What We Do:** examine how taxpayer dollars are spent and advise lawmakers and agency heads on ways to make government work better

• **Recent Results:** identified $74.7 billion in savings in 2015—for every $1 of our budget, returned $134 to taxpayers. Also identified 1,286 ways to improve government
Overview

- Background: U.S. affordable housing and LIHTC
- GAO audit of the LIHTC program: Findings and recommendations for improvement
- Promising practices to consider when designing or implementing tax initiatives
Background: Public Funding for Affordable Housing in the United States

Direct Expenditures
- Rental Assistance
- Block Grants
- Loan Guarantees

Indirect Tax Expenditures
- Low-Income Housing Tax Credit

Affordable Rental Housing in the U.S.

Source: GAO.
Background: Federal Rental Housing Assistance Does Not Fully Address Housing Needs

2013 (total households in thousands)

- Assisted renters: 5,530
- Unassisted renters with no housing problems: 18,107
- Unassisted renters with housing problems: 16,636

Source: Department of Housing and Urban Development.
Background: What Are Tax Initiatives?

- Also known as tax expenditure programs, these initiatives are reductions in tax liability of individuals or corporations.

- Can be used for various policy goals, including encouraging economic development in disadvantaged areas and financing postsecondary education.

- Forgone revenue can be of the same magnitude or larger than related federal spending for some mission areas.

Background: Attributes of Tax Initiatives

Compared with other spending programs, tax initiatives:

- Can incentivize—rather than require or prohibit—desired action/activity
- Can be added to the existing law and carried out by administrative structure
- Result in limited involvement by responsible federal agency—the tax beneficiary is responsible for claiming the benefit
- Are not included in the regular budget review process or subject to periodic oversight

## Background: Potential Pros and Cons of Tax Expenditures versus Spending Programs

<table>
<thead>
<tr>
<th>Policy tool</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax Expenditure</strong></td>
<td>Benefits are widely available</td>
<td>Difficult to target those without an income tax filing requirement or low tax liabilities</td>
</tr>
<tr>
<td></td>
<td>A benefit or incentive linked to income may be administered through tax collection agency at a relatively low cost</td>
<td>May add to the complexity of the tax system</td>
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<td></td>
<td>May simplify the tax system’s operation, (e.g., a threshold for capital gains from the sale of a residence below which taxes are not assessed)</td>
<td>Generally do not enable the same degree of agency discretion as spending programs</td>
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<td></td>
<td>The variety of tax expenditure types allows for flexibility</td>
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</tr>
<tr>
<td><strong>Spending program</strong></td>
<td>May be specifically designed for low-income families who are not subject to income taxes</td>
<td>May rely less on economic incentives and private market provisions, reducing efficiency for some goals</td>
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<tr>
<td></td>
<td>Better suited to funding programs when direct provision by the federal government is warranted, such as the armed forces and justice system</td>
<td>May respond less rapidly to changing economic conditions</td>
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<td></td>
<td>May receive more year-to-year oversight</td>
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<td></td>
<td>Provides flexibility for policy design</td>
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Background: Most U.S. Tax Benefits Focus on Making Homeownership More Affordable

Estimated Forgone Tax Revenue for Housing Policy Goals, 2015

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<th>Policy Goal</th>
<th>Estimated Forgone Tax Revenue (in billions)</th>
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<tr>
<td>Home mortgage interest deduction</td>
<td>71.0</td>
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<tr>
<td>Homeowner property tax deduction</td>
<td>32.4</td>
</tr>
<tr>
<td>Capital gains exclusion on sale of home</td>
<td>24.1</td>
</tr>
<tr>
<td>Low income housing tax credit</td>
<td>7.6</td>
</tr>
<tr>
<td>Other tax expenditures for rental housing</td>
<td>5.7</td>
</tr>
</tbody>
</table>

Background: LIHTC by the Numbers

• As of 2015, almost $8 billion in forgone revenue

• Since inception (1986), financed nearly 2.8 million rental units

Background: Additional LIHTC Examples

Rural LIHTC property in Lamont, California

Rural LIHTC property in Shiprock, New Mexico
LOW-INCOME HOUSING TAX CREDIT

Joint IRS-HUD Administration Could Help Address Weaknesses in Oversight
Audit Objectives

1. Describe how the LIHTC program is administered

2. Evaluate processes for overseeing the LIHTC program

3. Compare the administration of other tax credit programs with LIHTC
Objective 1: LIHTC – Who Is Involved

[Diagram showing the flow of money and tax benefits involving Internal Revenue Code (26 U.S.C. § 42(h)(3)), State housing finance agency, Investor, Syndicator (if used), Developer, Lender, and State housing finance agency.]
Objective 1: LIHTC Is Administered by the U.S. and State Governments

- The federal tax collection agency (Internal Revenue Service) provides regulatory direction and oversight to the LIHTC program.

- State agencies are responsible for awarding tax credits and monitoring projects.

- LIHTC projects often use multiple federal and private funds:
  - Additional oversight may be conducted by other government entities and the private sector.
Objective 1: State Agencies Are Responsible for Awarding Tax Credits and Monitoring Projects

**State Agency**
- Agency develops regional plan based on tax code requirements for specific selection criteria used to judge applications
- Reviews application and cost information to determine tax credit amount
- Selects projects

**Taxpayers**
- Application

**Developer**

**Agency**
- Agency sends form to tax collection agency
- Agency reviews final costs by required deadline
- Agency’s annual compliance monitoring activities report

**Tax Collection Agency**
- If applicable, any time during compliance period, agency reports noncompliance

**Timeline**
- Year 1 to Year 15

*Source: GAO.*

Taxpayers can claim a tax credit over 10 years if they meet the affordability requirements for 15 years.
Objective 2: Tax Collection Agency Conducted Minimal Monitoring

- Limited review of state agencies’ development plans
- Minimal audits of state agencies to ensure federal regulations and guidance were being followed
  - Conducted seven state reviews since 1986
Objective 2: Lack of Goals and Performance Measures

Tax collection agency:

• Did not collect information to evaluate the program

• Focused on tax compliance, not program evaluation
Objective 2: Limited Available Data on Program

- Data not reliable to assess compliance issues identified by state agencies
- Legal issues prevented information sharing between the tax collection agency and other federal agencies
Objective 3: LIHTC Differs from Some Other Tax Credit Programs

• Federal tax collection agency jointly administers some programs with other federal agencies

<table>
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<tr>
<th>Administrative structure</th>
<th>Low-Income Housing Tax Credit Program</th>
<th>Historic Rehabilitation Tax Credit Program</th>
<th>New Markets Tax Credit Program</th>
</tr>
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<tr>
<td>Other federal entity with formal administrative role</td>
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Source: GAO.

• Federal housing agency’s experience in affordable housing may benefit LIHTC
  ➢ Joint administration may require additional housing agency resources
Some Reasons for Deficiencies

Tax collection agency:

• Tax compliance main concern, rental housing is peripheral
• Limited staff and other resources
• Lack of subject matter expertise
• Nature of tax expenditures and lack of transparency around performance measures

Statutory limitations:

• Program design
• Data sharing
Recommendations

• Congress should consider joint administration of LIHTC by tax collection agency and federal government’s lead housing agency

• Tax collection agency should address identified data weaknesses
Key Takeaways

• Tax initiatives can play a role in meeting the United Nations sustainable development goals, such as:
  ➢ Reducing inequalities,
  ➢ Developing sustainable cities and communities, and
  ➢ Partnership for the goals

• Key agencies play an important part in monitoring and assessing the performance of tax initiatives

• Tax collection agency may not always have the expertise or experience to address the goal of the tax initiative
Promising Practices to Consider When Designing or Implementing Tax Initiatives

Consider:

- Administrative Structure
- Monitoring
- Performance Measurement and Data Collection
Tax Initiatives for Affordable Rental Housing in Different Countries

• Not known to what extent tax initiatives are used by other countries

• Australia awarded projects through the National Rental Affordability Scheme tax initiative from 2008 through 2010

• Research organizations in Canada and the United Kingdom have suggested tax initiatives for affordable housing

Future Work on LIHTC

• Evaluation of state agencies’ implementation of LIHTC
  ➢ Expected publication: May 2016

• Analysis of trends in LIHTC development costs
  ➢ Expected publication: Early 2017
Resources

• Link to GAO LIHTC Report

• GAO work on tax expenditures
  ➢ http://www.gao.gov/key_issues/tax_expenditures/issue_summary

• GAO’s Center for Audit Excellence
  ➢ Works to promote good governance and build the capacity of domestic and international accountability organizations
  ➢ http://www.gao.gov/resources/centerforauditexcellence/overview
Speaker Contact Information

Daniel Garcia-Diaz
Director, Financial Markets and Community Investment
U.S. Government Accountability Office

garciadiazd@gao.gov

Nadine Raidbard
Senior Analyst, Financial Markets and Community Investment
U.S. Government Accountability Office

raidbardn@gao.gov