

United States Senate

WASHINGTON, DC 20510

June 23, 2023

The Honorable Janet Yellen
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Yellen,

We write to urge the U.S. Department of the Treasury (Treasury) to provide written guidance that clarifies that the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, are not Tax-Exempt Controlled Entities (TECE) under Section 168(h)(6)(F)(i) of the Internal Revenue Code (IRC). Recently, tax counsel for some Low-Income Housing Tax Credit (LIHTC) investors have questioned whether the Federal Housing Finance Agency's conservatorship of Fannie Mae and Freddie Mac, and the Treasury Department's senior preferred stock and stock warrants in the GSEs, make them tax-exempt controlled entities. It's imperative for Treasury to issue guidance as uncertainty about the tax status of the GSEs is having a negative impact on their ability to invest in multi-investor LIHTC funds and to fulfill their statutory Duty to Serve requirements in underserved rural areas.

Housing affordability issues are not limited to large urban areas. According to the Housing Assistance Council, over 5.6 million – or one quarter of rural households – pay more than 30 percent of their monthly income toward housing costs and are considered cost burdened. The GSEs are significant LIHTC investors in rural areas because of their statutory Duty to Serve requirements and the limited number of banks incentivized by the Community Reinvestment Act. Given the size of deals in rural areas, it is more common for these projects to be funded through multi-investor funds. Unfortunately, uncertainty around the tax-exempt controlled entities (TECE) issue, where involvement in a multi-investor fund taints the fund for all participating investors, has sidelined the GSEs from participating in multi-investor Funds that deliver the majority of capital to rural LIHTC deals.

It should also be noted that clarifying that the GSEs are not tax-exempt controlled entities is not only vital to the continued creation of affordable housing for working families, it would also reflect the will of Congress and comport with federal law. Fannie Mae and Freddie Mac are taxable entities that pay billions of dollars in federal taxes. In fact, a corporation organized under an Act of Congress which is an instrumentality of the United States is exempt from federal income taxes only if the Act or the Code provides for such exemption. Consequently, the GSEs are not tax-exempt organizations. However, because Treasury, a tax-exempt entity, could be treated as holding more than 50% of the value of each GSE's stock, the issue is being raised by stakeholders whether the GSEs are tax-exempt controlled entities. We believe the GSEs should not be considered TECEs because the tax-exempt controlled entity rule was designed to deal with lease and partnership relationships between taxable entities and tax-exempt entities that could be structured to give the tax-exempt entity the benefit of tax incentives even though they are not taxpayers; a situation that is not at all relevant to the GSEs investment in LIHTC partnerships. For example, the TECE rule would apply if a taxable entity entered into a tax-advantaged investment (such as the construction of a building) and leased the building to a tax-exempt entity in a

structure that transfers some of the tax benefits to the tax-exempt entity in the form of lower lease payments. Congress enacted the nontaxable use restriction to prevent tax-exempt entities from indirectly gaining, through leasing for example, the benefits of both tax-exemption and the tax credit.

While most of the concern focused on leasing transactions, Congress was also concerned that taxable and tax-exempt entities might attempt to avoid the restrictions through the use of partnerships that would use disproportionate allocations of items of income and loss to achieve the same result. Consequently, Congress enacted what is now section 168(h)(6)(A), which treats an amount equal to the tax-exempt partner's proportionate share of the partnership's property as tax-exempt use property. Congress made it clear that the "policy underlying the restriction on tax-exempt use property is to provide tax-reducing incentives only to those who are subject to income tax, and to deny them to tax-exempt entities."¹ It seems clear that the potential abuses for which Congress constructed the tax-exempt controlled entity rules do not apply in this situation. Treasury's relationship with the GSEs established through the preferred stock purchase agreement, and the GSE's investment in the LIHTC program, are not the type of activities intended to be affected by 168(h)(6).

While we are confident that the GSEs should not be treated as tax-exempt controlled entities, we understand that tax counsel for LIHTC investors may be concerned about a negative determination from the IRS. In addition, we understand that the GSEs are limiting their participation in LIHTC projects that also involve historic rehabilitation credits due to the TECE issue. As a result, we request that you issue clarifying guidance that the GSEs are not subject to the TECE rule for purposes of LIHTC partnerships. We share a dedication to our communities and hope we can work together to expand affordable housing opportunities in rural communities. We look forward to your response.

Sincerely,



Mark R. Warner
U.S. Senator



Jerry Moran
U.S. Senator



Tammy Baldwin
U.S. Senator



Mike Braun
U.S. Senator

¹ Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* at 92 (5/4/1987) ("1986 Bluebook").



Sherrod Brown
U.S. Senator



Shelley Moore Capito
U.S. Senator



Susan M. Collins
U.S. Senator



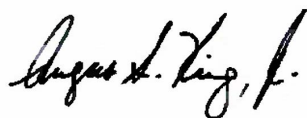
Deb Fischer
U.S. Senator



Chuck E. Grassley
U.S. Senator



Tim Kaine
U.S. Senator



Angus King, Jr.
U.S. Senator



Roger W. Marshall, M.D.
U.S. Senator



Gary C. Peters
U.S. Senator



Bernie Sanders
U.S. Senator



Jeanne Shaheen
U.S. Senator



Debbie Stabenow
U.S. Senator



John Thune
U.S. Senator



Peter Welch
U.S. Senator



Ron Wyden
U.S. Senator



Todd Young
U.S. Senator

cc: The Honorable Daniel Werfel
Commissioner
The Internal Revenue Service
1111 Constitution Avenue, NW
Washington D.C. 20224