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PRESIDENT'S ADVISORY  
PANEL  
ON FEDERAL TAX REFORM

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Dear Advisory Panel on Federal Tax Reform:

I am writing to ask that you work to change the tax law so elderly people don't have to pay taxes on "phantom income," which is an unfair tax on income we never received.

Here is the terrible problem produced by our federal tax laws for a limited partner investor in low income housing: phantom income. Our tax laws cause a passive investor to pay tax on income not earned or received whenever the operation of the partnership produces a "negative basis" in his partnership account. That negative basis, purely through tax law accounting, and not because of profitable operation of the partnership, is taxed as ordinary income to the investor. That means paying tax on income never received.

Phantom income is a huge burden for the elderly and those on fixed incomes, such as myself. Because of limitations on what the partnership can do with low income housing (fixed rents), there is no practical possibility of receiving cash income to pay the tax from phantom income.

Let me explain my situation in more detail:

I am a World War II veteran 88 years old. In 1981 I acquired a 21.43% ownership in a HUD Federal government-subsidized housing project, for the sum of \$63,000. I did this because I thought it would be a safe government-backed investment and would give me some income above Social Security in my retirement years.

But last year (2004), for example, I received a K-1 statement showing that I earned \$55,241 even though I actually received only \$8289 cash. The balance was kept in a reserve fund but I still had to pay taxes on the \$55,241. At a 28% tax rate the Federal tax was \$15,467 and the Wisconsin tax at 6.57% was \$3729, for a total of \$19,196 taxes I had to pay while receiving only \$8289 in payments. So the investment that was supposed to pay me extra retirement income instead cost me \$10,907 in only one year!

A similar situation has been going on for several years, and I am told it will continue for the next eight years, until the mortgage is paid off.

The difference between the cash I received and the amount the tax laws say I "earned" is called "phantom income." This part of my income is placed in a reserve fund to cover expenses that may occur in some future years.

I think there are several questions that should be answered:

- (1) Why would a federal agency enter into a 30-year contract at a 13% rate of interest with no adjustment provision in case interest rates drop and no ability to prepay the mortgage without penalty?
- (2) How could a \$63,000 investment produce a \$55,241 profit in one year based on a government subsidized housing project?
- (3) How much profit above taxes is WHEDA, the administrative agency, earning when the stock holders are penalized by being forced to pay considerably more income tax than the cash distribution they received?
- (4) I have been advised by several competent tax advisors that it is unlikely I can do anything about this situation unless the tax laws are changed regarding phantom income.
- (5) I have also been informed that in about eight years, when the mortgage is paid in full, this will become a profitable investment and I will benefit from it. But I am 88 years old with COPD and being able to enjoy this investment in eight years sounds to me as likely as that I will take a trip to the moon.
- (6) I hope the Senators and Representatives working on tax reform will recognize this as a very unfair investment, especially for supplemental retirement income, and will take steps to remedy it.

Thank you for any favorable consideration.

Respectfully submitted,

  
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407-788-9330

P.S. The program described above is  
Western Wisconsin Housing and Economic Development Authority  
WHEDA #007/000509  
HUD # WI39-H200-202