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## Q&A Single Tier vs. Master Lease Structure

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**Q**uestion: What are some common differences for a historic tax credit (HTC) project using the single tier structure vs. the master lease structure?

**A**nswer: First, we must have an understanding of the two types of structures before we can discuss the relative advantages and disadvantages of each.

The traditional structure, which is often referred to as the single tier structure, or direct investment structure, is similar to that which is used in the low-income housing tax credit world. A single entity owns the historic property and incurs all of the qualified rehabilitation expenditures (QRE). Prior to the property being placed in service, a historic tax credit investor is admitted into the partnership for the majority ownership, usually 99.99 percent, and the general partner retains a .01 percent interest. Generally, allocations of income, loss, tax credits and cash flow are made to the partners in proportion to the partnership interests, subject to certain limitations.

The master lease structure utilizes two entities in its structure. The lessor (landlord) entity is the owner of the historic property and incurs the qualified rehabilitation expenditures. The other entity is the lessee (master tenant) entity. This entity will master lease the property from the landlord, will lease the space, be it to residential or commercial tenants, and pay all property operating expenses. In general, the landlord entity is owned by the developer, usually holding an 85 percent to 90 percent ownership interest, and the master tenant entity will hold the remaining 10 percent to 15 percent ownership interest. The master tenant entity, similar

to the single tier structure, will admit a tax credit investor for a 99.99 percent ownership interest prior to the property being placed in service, and a general partner/managing member will retain a .01 percent ownership interest. Under this structure, the landlord will make an election to pass through all or portion of the historic tax credits to the master tenant. Treasury Regulation §1.48-4 permits the landlord and master tenant to mutually agree by way of an election to treat the master tenant as having incurred the QREs incurred by the landlord. Thus, the master tenant entity reports the QREs on its federal income tax return.

Now let's look at a few of the advantages and disadvantages of each type of structure from the developer's and investor's perspectives. First, let's examine one advantage that the single tier structure has over the master tenant structure: its simplicity. Because there are fewer entities involved and fewer documents required, this structure when compared to the master tenant is easier for the developer to manage and will tend to have fewer initial and ongoing transactions costs associated with it. One disadvantage to this structure is that the investor is entitled not only to the majority of the income tax benefits from depreciation deductions allocated as part of the overall allocation of taxable income or loss of the partnership (again subject to certain limitations under IRC §704(b)), but will be allocated 99.99 percent of available cash flow from the project by virtue of its ownership interest. In this case, the developer is potentially "giving away" some of the benefits that it might otherwise be able to retain. If a master tenant structure were to be used, the developer, through its majority ownership of the landlord, would retain

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the majority of the project's cash flow and potential tax losses.

Looking at the master tenant structure, one primary advantage is that the mandatory basis reduction of the depreciable property and the HTC investor's basis in its partnership interest, which is required under a single tier structure, does not apply to a master tenant structure in which the HTC is "passed through" to the master tenant. This is important to the developer because now the landlord entity will generate larger depreciation deductions, most of which will be allocated to the developer. The importance of this to the HTC investor is that it will not have to reduce its basis by the amount of the HTC. This is key because now the HTC investor under the master tenant structure will have a much higher basis, which has a significant positive impact in reducing any potential capital gain or increasing any capital loss to the investor at the time it sells its ownership interest in the project after the HTC compliance period.

These are just a few of the advantages and disadvantages of the single tier structure and the master lease structure. When given all the facts and circumstances of a transaction, care should be taken in analyzing what constitutes the best structure. Working with your tax advisor is critical to making the best decision. ❖

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