Summary: March 4, 2014

In this week's Tax Credit Tuesday podcast, Michael J. Novogradac, CPA, discusses House Ways and Means Committee Chairman Dave Camp's release of a discussion draft of tax code reform proposals and a little about the fiscal year 2015 budget. In low-income housing tax credit news, he analyzes the calendar year 2014 population estimates, discusses the extension of the Physical Inspection Pilot program and alerts listeners to changes in Ohio's policies for change of management or ownership of LIHTC properties. In new markets tax credit news, he alerts listeners to a change in the amount of allocation authority the Community Development Financial Institutions Fund will award this year. In historic tax credit news, he discusses a recent U.S. Tax Court case in which the court ruled that a state tax credit transaction was a disguised sale. In renewable energy tax credit news, he shares responses from the U.S. Department of the Treasury about the possibly of using investment or production tax credits to offset lower amounts of Section 1603 cash grant funding caused by sequestration and he discusses a recent report from the National Renewable Energy Laboratory about the effectiveness of state-level solar development policies.

Summaries of each topic:

GENERAL NEWS

- When I mentioned last week that I would discuss Rep. Dave Camp's tax reform proposal in this week's Tax Credit Tuesday, I didn't expect that I'd have so much to talk about.
- I start this week's general news section with a discussion of the Tax Reform Act of 2014.
- The House Ways and Means Committee Chairman released the tax reform discussion draft on Feb. 26. And let me emphasize –
  - It is a DISCUSSION DRAFT.
- That said, it is a comprehensive 979-page document that offers a major overhaul of the tax code.
- That overhaul addresses the
  - low-income housing tax credit,
  - historic tax credit,
  - renewable energy investment tax credit and
  - renewable energy production tax credit.
- It also includes changes to a number of other tax credit programs and tax expenditures related to community development and affordable housing production.
- Here's the short version of the discussion draft's treatment of tax credit programs.
  - It repeals the historic tax credit.
  - It repeals the investment and production tax credits for renewable energy.
  - It makes no mention of the new markets tax credit.
    - The draft is comprehensive, so this means that Camp is proposing not to renew the expired program.
  - It repeals the brownfields tax credit and work opportunity tax credit.
  - It keeps the Empowerment Zone/Enterprise Community related tax credits expired. It does not continue them.
- One area of positive news is the draft keeps the Low-Income Housing Tax Credit program.
- However, while retention of the LIHTC is very positive news, the discussion draft proposes to make several significant changes to how the LIHTC would operates,
  - changes which are nearly all adverse to the ability of state allocating agencies to best use the credit to produce affordable rental housing.
- Here are the proposed changes:
  - It repeals the so-called 4 percent low-income housing tax credit.
  - It also repeals the basis boost for qualified census tracts and difficult development areas.
  - It eliminates the national pool of unused low-income housing tax credits.
  - It would extend the credit period to 15 years from 10 years.
    - This would match the compliance period and eliminate the need for recapture rules.
    - The annual percentage rate would decline, but the total credits that a project would qualify for would increase.
  - It would also keep the floating rate for the 9 percent low-income housing tax credit.
    - We estimate that this would result in the current 7.60 percent rate claimed over 10 years falling to 5.32 percent a year for 15 years.
    - Therefore, over the 15 years of the proposal, total credits would rise from 76 percent of qualified basis to 80 percent.

    - Another interesting programmatic change is that states would no longer allocate tax credits: instead
        - They would allocate qualified basis.
    - States currently allocate tax credits, and maximum qualified basis and maximum credit percentage.
    - For more details on these provisions, I invite you to review my blog posting, at novogradac.wordpress.com
- In general, the affordable housing industry has applauded Rep. Camp's retention of the low-income housing tax credit program, but it has also expressed serious reservations about the effect that the changes could have on affordable housing development.
- Stakeholders are particularly concerned about the elimination of the 4 percent credit and the elimination of private activity bonds.
    - Enterprise, for example, noted that tax-exempt bonds finance about 40 percent of LIHTC developments and that without them the ability to develop and preserve affordable housing would be severely impeded.
    - The ACTION Campaign expressed similar concerns.
- Those in the historic tax credit and new markets tax credit industries also expressed serious concern.
- The New Markets Tax Credit Coalition said that the omission of the New Markets Tax Credit program in the tax code would cost jobs and revenue in low-income communities.
- Preservation Action, along with the National Trust for Historic Preservation, is circulating a letter in support of the historic tax credit program.
    - They also plan to discuss the program with lawmakers this week as part of a scheduled Advocacy Week that starts today.
- I'll provide more industry reaction in the next few podcasts.
- The general consensus is that this discussion draft will be important in future tax reform discussions, but legislative activity is not expected in the near term.
- We note, at the time of this recording, no hearings had been scheduled.
- So what was the Senate's reaction?
- Senate Finance Committee Chairman Ron Wyden and Ranking Member Orrin Hatch released a joint statement on the proposal.
    - They stuck to supporting the general concept of tax reform and commended Rep. Camp for the effort he has put into the cause.
    - They didn't endorse any of the provisions in the draft.
- I'll keep you updated via Twitter and breaking news alerts about any legislative developments.

Fiscal Year 2015 Budget

- In budget news, sources are reporting that the Senate does not plan to pass a budget this year.
- Senate Budget Committee Chairwoman Patty Murray said Friday that the spending levels for fiscal year 2015 have already been set.
- Instead, the Senate will focus on longer-term budget priorities.
- President Barack Obama is also releasing his fiscal year 2015 budget request today.
- I'll be reviewing his budget proposal this week and will share my thoughts in next week's podcast.
- Look for breaking news and blog posts over the next few days with details regarding the budget request.

NOVOGRADAC
TAX CREDIT TUESDAY
PODCAST

Summary: March 4, 2014

LOW-INCOME HOUSING TAX CREDIT NEWS

IRS Releases 2014 Population Estimates, LIHTC/Bond Caps

- In low-income housing tax credit news, I begin with the release by the Internal Revenue Service, or IRS, last week of updated population numbers for 2014.
- The population numbers are used to calculate the amount of LIHTCs and private activity bonds states and U.S. possessions can issue.
- The IRS's figures are based on data published by the Census Bureau in December.
- IRS Notice 2014-12 sets the state credit ceiling at the greater of $2.30 multiplied by the state population or the small-state minimum of $2.635 million.
- The top five states in term of allocation authority for 2014 are
    1. California with $88.1 million;
    2. Texas with $60.8 million;
    3. New York with $45.2 million;
    4. Florida with $45 million; and
    5. Illinois with $29.6 million.
- Let's turn our attention now to states or areas that will receive the $2.635 million LIHTC small-state minimum in 2014.
- They're the same eight states, four US possessions and District of Columbia that received the minimum in 2013.
- The eight states receiving the small state minimum are:
    1. Alaska
    2. Delaware
    3. Montana
    4. North Dakota
    5. Rhode Island
    6. South Dakota
    7. Vermont
    8. Wyoming
- The four U.S. possessions are:
    1. Guam
    2. Northern Mariana Islands
    3. U.S. Virgin Islands
    4. American Samoa
- For private activity bond caps, the calculation is the greater of $100 multiplied by the state population or about $297 million.
- The five states with most bond allocation authority for 2014 are the ones with the most LIHTC allocation authority as you'd expect.
- They are
    1. California with $3.8 billion;
    2. Texas with $2.6 billion;
    3. New York with about $2 billion;
    4. Florida with about $2 billion; and
    5. Illinois with $1.3 billion.
- Twenty states will receive the nearly $297 million small-state minimum for bonds in 2014.
- They are largely the ones that received the minimum in 2013.

- I'll note that West Virginia and Wyoming have been added to the 2014 list.
- Four states that received the bond small-state minimum in 2013 will not receive the bond small-state minimum in 2014 because their population has grown.
- They are
  - Kansas
  - Mississippi
  - Nevada
  - Utah
- If you'd like to review the population figures on your own, you can find Notice 2014-12 at www.taxcredithousing.com.

IRS Extends Physical Inspections Pilot Program Deadline

- In other low-income housing tax credit news, the IRS extended the deadline for state housing finance agencies, or HFAs, in the Physical Inspections Pilot Program to meet certain physical inspection and certification requirements under Section 42.
- The deadline is now Dec. 31, 2014.
- The extension applies to HFAs that participated in the pilot program in 2013 and/or 2014.
- The pilot program was created by the Rental Policy Working Group, which was established by the White House Domestic Policy Council.
- The program's purpose was to find ways to avoid duplicative physical inspections by conducting one coordinated inspection.
- The pilot program is being tested in six Midwest and Northwest states:
  - Michigan,
  - Minnesota,
  - Ohio,
  - Oregon,
  - Washington and
  - Wisconsin.
- The HFAs in the six states may satisfy their property inspection responsibilities by using either their current property-inspection protocol or that of HUD's Real Estate Assessment Center, or REAC.
- The goal is to create savings for property owners and managers, and to reduce cost burdens on local, state and federal governments.
- If you have any questions about physical inspection requirements under Section 42 or the pilot program, please contact my partner Jim Kroger in our San Francisco office.
- You can reach Jim by phone at 415-356-8000 or by email at Jim.Kroger@novoco.com.

OHFA Changes Ownership/Management Company Policy

- In state-level news, the Ohio Housing Finance Agency, or OHFA, announced a new policy on ownership changes for low-income housing tax credit properties.
- This state level update is a good reminder to all low-income housing tax credit property owners, as I will expand on later, to review their obligations to seek approval of changes in ownership and property management companies for their low-income housing tax credit properties.
- OHFA said that those requesting a general partner change for a LIHTC property must submit about a dozen documents including

  - a cover letter explaining the reason why an ownership change is necessary;
  - a completed pro forma;
  - prior years' audited financial statements; and
  - current year-to-date audited financial statements.
- Requests to change a limited partner interest require
  - a cover letter explaining why a partnership change is necessary;
  - a summary of the new limited partners experience in affordable or rental housing; and
  - information on the performance of the limited partner in owning and/or renting housing.
    - Information must include any housing or code violations.
- An owner's request to change a property management company will be reviewed by OHFA on a case-by-case basis. An owner request to change the property management company must include the following:
  1. A cover letter fully explaining why the property management company change is necessary;
  2. Summary of the property management company's experience in managing affordable housing;
  3. A description of the capacity of the new management company, namely, trade association memberships and compliance certifications; and
  4. OHFA's Management Company Capacity Questionnaire must be completed.
- I should note, OHFA said it may later require additional documents not contained in the lists.
- You can find a copy of the OHFA notice at www.taxcredithousing.com.
- As mentioned earlier, this update from Ohio is an excellent opportunity for me to remind LIHTC property owners or managers to consult your state's housing finance agency before attempting any general partner or limited partner changes or property management changes.
- If you have any questions about changing general or limited partners, please contact my partner Renee Beaver in our Cleveland, Ohio office.
- You can reach Renee at Renee.Beaver@novoco.com.

NEW MARKETS TAX CREDIT NEWS

CDFI Fund to Award Only CY 2013 NMTC Allocation Authority

- In new markets tax credit news, I have an update to the CDFI Fund's Notice of Allocation Authority, or NOAA, for the combined calendar year 2013 and 2014 allocation round.
- The CDFI Fund released a notice last week that it would only be awarding the $3.5 billion in allocation authority.
- That's the allocation authority that Congress has already authorized.
- It will not be awarding the up to $5 billion in allocation authority that it had anticipated being authorized for calendar year 2014.
- Regular listeners may recall that in July 2013, the CDFI Fund announced that up to $8.5 billion in allocation authority might be available for this round.
  - That included $3.5 billion authorized by the American Taxpayer Relief Act of 2012 and an additional $5 billion subject to congressional authorization.
- At the time of this recording, Congress has not authorized allocation authority for 2014.
- That means only $3.5 billion will be available for the current round.
- The CDFI Fund said it will be capping awards at $100 million per allocatee, down from the $125 million limit included in the July notice.
- In the July 2013 announcement, the CDFI Fund said that if Congress did not authorize 2014 allocation by early 2014, it would only award the 2013 allocation authority.
  - Pending congressional authorization, it would consider combining calendar year 2014 and 2015 NMTC authority.
- At the time of this recording, the CDFI Fund has not said if it would be implementing that plan.
- Last week's update does not mention future application rounds.
- The CDFI Fund said that it expects to announce calendar year 2013 awards later this spring.
  - This is in line with what we've been hearing for the last few months.
  - We are anticipating an announcement near the end of May or early June.
- The lower cap and lower allocation amount is going to have a significant effect on the number of community development entities that receive allocation and how much allocation they receive.
- Most applicants already have projects in mind when they apply for NMTC authority.
  - As a consequence we will see some projects put on hold or delayed.
- If you'd like to view the NOAA, we have it available at www.newmarketscredits.com.
- If you have any questions about the funding round, please contact my partner Diana Letsinger in our Long Beach office.
- You can reach Diana at 562-432-9482.

HISTORIC TAX CREDIT NEWS

- In historic tax credit news, I'd like to discuss a recent case in which the U.S. Tax Court classified another transfer of state tax credits as a disguised sale.
- In the Route 231 LLC case, the U.S. Tax Court held that Virginia state tax credits are property and, under the facts of the case, the allocation of tax credits to the partner was a disguised sale.
- The case concerns a transfer of Virginia Land Preservation Tax Credits.
- Virginia Land Preservation Tax Credits are provided to landowners who donate land or conservation easements.
  - The recipient can use the tax credits or sell them to another party.
- In this case, Route 231 provided tax credits from two parcels of land to a partner and the partner provided Route 231 53 cents on the dollar for each tax credit.
- Route 231 contended that the investor was
  - a partner in the project,
  - made capital contributions
  - and that the investor had been allocated the tax credits through its participation as a partner in the partnership.
- This would make the transactions non-taxable.
- The Internal Revenue Service, however, contended that Route 231 sold the tax credits to the investor partner and so the transaction should be taxable.
- At issue were at least two questions:
  1. Were the credits "property"?
  2. Were the credits allocated or transferred?
- The court determined that
  1. In this case, the state tax credits were property, and
  2. The credits were transferred.
- Therefore, in the court's opinion, Route 231 had engaged in a disguised sale under Internal Revenue Code Section 707.
- A few key factors ultimately led to the court's ruling.
  1. Route 231 only transferred the tax credits because the investor partner provided cash to the project, or at least the court ruled that.
  2. The amount of credits received was based entirely on a fixed rate of return rather than on a share of partnership profits tied to Route 231's operations.
     - Once again, that's what the court determined.
- If you would like to review the court case or the recently released federal historic tax credit safe harbor guidance, please go to the Historic Tax Credit Resource Center.
- You can also contact my partner Charlie Rhuda in our Boston office.

RENEWABLE ENERGY TAX CREDIT NEWS

Section 1603 Program Participants Not Eligible for ITC, PTC

- In renewable energy tax credit news, I'd like to discuss a letter that Alastair M. Fitzpayne, the Treasury Department's assistant secretary for the Office of Legislative Affairs, wrote to three congressional representatives.
- The letter was in response to letters received from
  - Representatives
    - Juan Vargas,
    - Paul Cook, and
    - Susan Davis.
- The letters concerned Section 1603 cash grants received in lieu of tax credits as well as the impact of sequestration.
- Sequestration reduced Section 1603 payments by 8.7 percent in Fiscal Year 2013 and reduced payments by 7.2 percent in Fiscal Year 2014.
- This resulted in smaller than anticipated payments to some Section 1603 program participants and may have resulted in project funding shortfalls.
- The representatives, who are all from California, asked the Office of Legislative Affairs to consider allowing participants in the Section 1603 program to claim investment tax credits in the amount by which sequestration will reduce Section 1603 payments.
- However, under Section 48(d) of the Internal Revenue Code, any property that has received a Section 1603 payment cannot also receive production or investment tax credits.
- Because of this, Fitzpayne denied the representatives' request for Treasury to consider allowing Section 1603 projects affected by sequestration to claim tax credits.
- Fitzpayne said that Section 1603 program participants who have already received payments may not claim ITCs or PTCs, even if the payment amount has been reduced by sequestration.
- If a Section 1603 program participant has not yet received a Section 1603 payment, the participant may choose to claim tax credits instead of the grant.
- If you have any additional questions about the Section 1603 program, please contact my partner Stephen Tracy in our San Francisco office.

NREL Releases Solar Policy Study

- In other renewable energy news, the National Renewable Energy Laboratory, or NREL, released a report last month that aligns solar policy and market success with state demographics.
- The report is titled, "Effectiveness of State-Level Policies on Solar Market Development in Different State Contexts."
  - NREL is the U.S. Department of Energy's primary national laboratory for renewable energy and energy efficiency research and development.
- NREL put into context the effects of various solar policies on solar developments by organizing the 48 contiguous states into four peer groups,
  - The groups were based on shared non-policy characteristics, such as
    - Personal economic context represented by median household income;
    - The cost of competing grid electricity;
    - General community interest in energy conservation and renewable energy; and

        - The physical characteristics of homes and how sunny it is in a given area.
            - This factor includes an estimate of the rooftop area potentially available for solar.
- The study focuses of on low-cost government policies and how they can be implemented to support installation of solar developments.
- The report acknowledges that direct financial incentives play a role in the development of solar markets, but the report does not address that topic.
- The report did talk briefly about a few tax credit incentives in Maryland, North Carolina and New Mexico.
- It says that Maryland has implemented a variety of market expansion policies to address higher-level barriers like technology first-costs and investment uncertainty.
    - These policies include:
        - production tax credits,
        - equipment sales tax exemptions,
        - property tax exemptions, and
        - rebate programs.
- In addition, since 1997, North Carolina has had a 35 percent personal and corporate tax credit for renewable energy installations, according to the report.
    - The report went on to say this makes systems more affordable for developers and draws new participants into the market.
- Finally, the report says that New Mexico has also implemented a number of market expansion policies.
    - In 2006, the state enacted the Solar Development Tax Credit.
    - Currently, the program is a 10 percent credit that is independent of the investment tax credit.
- The lead author of this report, Darlene Steward, said that the study provides insight into the policy scope and quality that is needed to spur solar markets across the country.
- This summer, NREL is expected to release supplementary information that identifies the most effective policy development strategies for each state.
    - It will also provide strategies for states to take action.
- We will be sure to update you on that information when it becomes available.
- To read the report, go to the Renewable Energy Tax Credit Resource Center.
- If you have questions about these policies, I encourage you to contact my partner Paul Charron in our San Francisco, Calif. office at 415-356-8071.