

## What to Know About Including Bond Issuance Costs in Eligible Basis After Tax Court Decision

The United States Tax Court ruled in a Feb. 20 decision that a taxpayer was correct to include bond issuance costs in eligible basis for a 4% low-income housing tax credit (LIHTC) property in New York City. That decision ran counter to more than two decades of practice that followed Internal Revenue Service (IRS) guidance from as far back as 2000 that said including such costs was disallowed. In the latest installment of Tax Credit Tuesday, Michael Novogradac, CPA, and Nicolo Pinoli, CPA, discuss the details of the case in question before the court as well as the possible ramifications of the decision, including what the IRS could do now and what this decision could mean for credit allocating agencies, developers, investors and others who build multifamily affordable rental housing using LIHTCs.

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## Transcript

### Introduction

[00:00:13] **Michael Novogradac, CPA:** Hello, I'm Michael Novogradac, and this is Tax Credit Tuesday. This is the March 12th, 2024, podcast. As our viewers on YouTube can see, I'm pleased to have my partner, Nicolo Pinoli, back as my guest this week.

Nicolo is one of Novogradac's leading experts on low-income housing tax credits, which makes him a great guest for today's topic. Nicolo is also lead editor, technical editor, I should say, on the Novogradac-authored Low-Income Housing Tax Credit Handbook.

Today, we're going to discuss a recent decision from the United States Tax Court. This decision has huge potential ramifications for developers, investors, syndicators and others involved in developing affordable rental housing with low-income housing tax credits.

We at Novogradac wanted to get this podcast out as quickly as possible because this decision just came out on Feb. 20. We wanted to discuss how this affects clients and what they can do now or at least should be thinking about now.

Now the decision concerns the question as to whether at least a portion of bond issuance costs can be included in tax credit basis. The Treasury Department and the IRS, for over 20 years, have argued that no portion of bond issuance costs can be included in tax credit basis. Now for the more technical among our listeners, the IRS articulated its position back in the year 2000, in Technical Advice Memorandum 2000-43-015.

And for those of you that are wondering how technical advice memorandums get their number, 2000 of the year, 43 is the week, and 15 is the 15th ruling during that week.

Now, in addition to this technical advice memorandum, the IRS also articulated this position in their Audit Technique Guide for Section 42, Low-Income Housing Tax Credits.

That said, developers and their advisors, including us at Novogradac, have long disagreed with this position, and this disagreement is what led to the recent tax court opinion.

The case involved the limited liability company 23rd Chelsea Associates, who back in 2002, that's right, 22 years ago, placed in service The Tate, an affordable rental housing property in New York City. The partnership did include a portion of bond issuance costs on an eligible basis.

Years later, the IRS audited the partnership's 2009 return and disallowed tax credits for 2009 that were claimed with respect to those bond issuance costs. The IRS also determined that they needed to recapture a third of those credits that were claimed for earlier years on those bond issuance costs. The taxpayer challenged this IRS determination. And they took the matter to tax court.

Fast forward to February 20th this year, and the United States tax courts ruled that the partnership was correct to include a portion of bond issuance costs in tax credit basis. And that is what led to today's podcast.

So today, we're going to discuss what this means for the affordable housing community. And we're still in the early stages. That said, developers should immediately address this question due to its potential impact.

For example, if you have a development that was recently placed in service, or is about to be placed in service, you need to determine whether or not you want to include a portion of bond issuance costs in an eligible basis.

By including them in eligible basis, I think it's pretty obvious, you may generate additional tax credits, which can lead to additional tax credit equity. And for many developments, the additional tax credit equity generated could total \$100,000 or more, potentially a lot more for very large developments.

Similarly, if you're in the early stages of developing a property, you should consider whether to include additional eligible basis in your pro forma, and more importantly, you should consider whether you have opportunities to restructure your bonds in a manner to increase the amount of bond issuance costs that may be included in an eligible basis.

Now, with all of this said, I do want to note that we, as I said earlier, are in the early stages of determining how the recent court decision will ultimately affect eligible basis for tax credit properties going forward.

Now, developers should seek to capitalize on the ruling now, but be mindful – it's still, there's still some wood to chop, if you will, with respect to determining the effects.

And I say this for several reasons. First, we need to see if the IRS is going to appeal the decision. Second, we need to see if the IRS will acquiesce to the decision. And third, we also need to see how tax credit allocating agencies will respond to the decision. There are other considerations as well, but I think I'll stop with those three.

And in today's discussion, I do want to first discuss the decision with Nicolo, have him share some of his thoughts and some of the history. And then we want to spend most of our time looking at the range of possible beneficial effects in terms of generating additional tax credit equity.

There's a lot to talk about on this topic, so if you're ready, let's get started.

## Guest Introduction

Nicolo, sorry for that lengthy introduction, but I wanted to set the stage. I appreciate your patience, and welcome back to Tax Credit Tuesday.

[00:05:35] **Nicolo Pinoli, CPA**: Thanks, Mike. It's great to be back.

[00:05:37] **Michael Novogradac, CPA**: So it's always a pleasure to have you back on the podcast. You're one of our more popular guests. Now, before we discuss today's topic, though, I did want you to share a little bit about the type of work you do for Novogradac clients, for our listeners.

[00:05:52] **Nicolo Pinoli, CPA**: Sure. Well, as a CPA, that means I do all of the usual traditional CPA services like audits and tax returns. But in addition, I tend to provide some more exotic services as well, and I spend a lot of time working with clients to close deals, structure deals, help them understand the program, work through issues like maximizing their eligible basis, which might be something we chat about today.

And then also work a lot on the unwind when it comes to exiting deals and working through that process.

## IRS Guidance and The Tate

[00:06:26] **Michael Novogradac, CPA**: Right. Thank you for that, Nicolo. Now, in the intro, I mentioned the guidance that the IRS issued in July of 2000 about bond issuance costs, and maybe we can start our discussion there and you could explain a little bit more of the back story about that technical advice ruling and a little bit more detail to what was involved in it.

[00:06:48] **Nicolo Pinoli, CPA**: Yeah, so Technical Advice Memorandum 2000-43-015 was quite a barn burner, and in that TAM, the IRS concluded, among other things, there was a long list of items discussed in that TAM, but among other things, they concluded the bond issuance costs should not be included in eligible basis, and I think part of the fun was the very next TAM, 016, they actually talked about construction financing and the fact that construction financing costs should be included in eligible basis, which left us all that much more excited by their reasoning in 015.

But when you look at 015 and you look at their reasoning, they went through this rather exciting analysis where they said, if we look at Section 142 and the legislative history there, there's this guidance, and for those of you not familiar, 142 deals with bonds, tax-exempt bonds, and the ability to use bond proceeds to pay for certain costs if your bonds are going to qualify.

And in that statute and in the guidance there in the legislative history, you see that there's a limit on the amount of the bond proceeds that can be used to be paid for bond issuance costs. And the IRS went through this analysis and said, and so therefore, well, bond issuance costs must be ineligible to be included in eligible basis.

And a lot of us in tax credit land looked at this ruling and said, well, I grant you that Section 142 and 42 happen to both have 42 in the number. So I guess there's some relationship there. And, but you know, when you start looking at things like the 95% test and which costs can be paid from bond proceeds, well, what does that have to do with the price of cheese in Rome? Because I'm not sure that it really has that much to do with whether or not bond issuance costs should really be included in eligible basis.

And so, over the last 20-plus years, many of us within the industry have really questioned their reasoning, but at the same time it takes a lot of chutzpah to really poke the bear and say, I think you're wrong. And so bravo to this particular taxpayer who went there and was willing to really fight this issue.

And I think there's a few exciting changes that have happened in our world over the last 25 years that are worth, I think, really digging into a little bit because it's really made this rule or this guidance a big deal a really big deal for 4% tax-exempt bond financed transactions.

And one of the issues that's changed is, historically, tax-exempt bond interest rates were low. They were lower than similar market-rate interest rates or non-tax-exempt interest rates and there was a pretty sizable discount due to them being tax-exempt.

And yet over time, that discount has disappeared, which means, as a result, that there's not a real positive benefit to keeping your bonds around as permanent financing.

And therefore, over the last 20, 25 years, it's become very common for tax-exempt bonds to be used almost exclusively for construction financing. And if you do keep them around on the permanent side, often it's a much smaller piece of your permanent financing, just because you don't have that favorable interest rate element.

I think, too, it's important to realize that bonds are expensive. Those bond issuance costs are often very expensive, and they can run well into six figures, sometimes even into seven figures, and so as a result, the exclusion of these costs from eligible basis can be very costly and very painful for many projects.

And you add it all up and the possibility of including bond issuance costs in eligible basis should make a big difference for a lot of projects and could make a really, the difference between a deal that works and one that doesn't in some cases.

[00:11:03] **Michael Novogradac, CPA:** No, thank you for that, and thanks for some of the background on the Technical Advice Memorandum, or TAM. I always think of this as gross simplification. When I think of that TAM, I think about the IRS looking at what you refer to as the good cost, bad cost tests for private activity bonds, or the 95/5 tests where 95% of the bond proceeds have to go for good costs and no more than 5% can go for bad costs.

And the IRS was basically saying this is a bad cost for purpose of determining whether or not your bonds are tax exempt, which makes it a bad cost for an eligible basis. Why?

[00:11:43] **Nicolo Pinoli, CPA:** And obviously our rejoinder was always, well, gee, land is a good cost for 95/5. So does that mean I can include it in eligible basis now?

[00:11:55] **Michael Novogradac, CPA:** Yes, yes, yes. The answer would be no.

[00:11:59] **Nicolo Pinoli, CPA:** Right, right.

[00:11:59] **Michael Novogradac, CPA:** So thank you for that. That gives good context to understand why the decision has potential effect to affect tax credit basis.

With that context, I wanted to dive now into the decision. I gave a bit of a background on the tax court decision, and, you know, I did sort of wreck the ending by pointing out that the conclusion, spoiler alert, bond costs can be, interest costs, a portion of them can be included in eligible basis.

That said, if you could share more of the details about the case to help inform listeners, give a little more background as to what actually happened in this court case and how this came to be something that the taxpayer, the partnership chose to litigate.

[00:12:49] **Nicolo Pinoli, CPA:** Absolutely. And in this case, The Tate was a 4% tax-exempt bond financed LIHTC transaction that was originally placed in service way back in 2002, happens to be the year I joined the firm right out of school.

The project deferred the first year of the credit period from '02 to '03, so the project began claiming credits in 2003. And in filing those tax returns and in claiming their tax credits, the taxpayer included a portion of the bond issuance costs in the calculation of eligible basis.

And they kept doing that all the way up through 2009. So this was Year 7 of the credit period when our good friends at the Internal Revenue Service opened an IRS examination or an IRS audit into this tax credit partnership. And as part of that examination, the IRS challenged the taxpayers inclusion of bond issuance costs in eligible basis, and you can imagine that the IRS went back to this previous guidance that it issued and said, it says right here, you can't include bond issuance costs in eligible basis.

Now, the process of the IRS examination took a grand total of 10 years, and in case you're wondering, that's not common. My experience is six months, maybe a year if things drag on, and you've got some back and forth, and it takes you a while to dig stuff up. Ten years is long, even for the IRS. Ten years is a long time, and if you will permit me to speculate just a little bit here and attempt to divine a little bit of what that means.

My guess is there, there was some, probably some back and forth going on as part of this process where the parties were looking to try to find a compromise. Maybe the IRS proposed something, the taxpayer proposed something, they were negotiating, there was a little dance going on. And I imagine, over at the IRS, this was probably getting kicked up. You know, the original agent who did the audit was probably looking at it saying, I don't think it works, they've got to exclude these costs, kicked it up to a supervisor, probably kicked it up a few layers.

And every time, the IRS probably took another look at it and said, yes, we want to die on this hill. We are absolutely certain the bond issuance cost cannot be included in an eligible basis.

And you think about it from the developer's side, of course, the developer, I'm guessing, they probably had multiple projects, many of which had probably included bond issuance costs on an eligible basis. So, this was a bigger issue for both parties at the same time where they cared very much about not just this particular situation in this particular case, but then the knock-on effects with other projects that had included bond issuance costs.

And so, therefore, as a result, it took a while for everybody to work through it. You can't blame the pandemic on these delays. This finally got resolved in 2019, pre-pandemic. But ultimately, the IRS issued their final administrative adjustment finding, and the taxpayer decided that that didn't work for them.

And so, the taxpayer took the case to the tax court, and the court took it up, and ultimately, spoiler alert, did rule in favor of the taxpayer, and found that the IRS' reasoning really didn't have any merit. But we'll get to that in a minute.

[00:16:27] **Michael Novogradac, CPA**: So thank you for that Nicolo. I think we now have a good sense as to, you know, how The Tate case came to be within the wider framework of the earlier guidance

from the IRS. So, the case mentions, or solutions as I mentioned, it determines that bond issuance costs, a portion of bond issuance costs can be included in eligible basis and claim tax credits.

The question then becomes, for us as accountants, how do you determine what portion of bond issuance costs get to be included on an annual basis? That'll be something that we'll be talking about a lot in the weeks and months ahead. But maybe share with listeners what some of the takeaways from the court case are in terms of how you determine the portion of bond issuance costs to include.

[00:17:17] **Nicolo Pinoli, CPA:** Well, as accountants, we love certainty, and we love specifics, and obviously that's the first place our mind goes to. It's great, I can include them, now tell me how I do the math.

And in this particular case, the court seemed a little bit cagey on that, just not giving us the details we really crave. And throughout the decision, they used the term allocate and allocable and didn't really give us a tremendous amount of math behind here's the different steps you take and really focused on the notion that the taxpayer was really just up to one thing, which was building the property and the financing was an integral part of building the property.

And so, therefore, to the extent that the financing costs were allocable to the construction period. Therefore, those costs should be ported right on over and capitalized to the property and therefore included in eligible basis.

[00:18:18] **Michael Novogradac, CPA:** And I guess I would say that the case did include a chart where the taxpayer had went through and took various bond issuance costs and made a determination as to what portion of each cost was included in eligible basis.

And as far as I could tell, the court basically just took what the taxpayer provided and accepted the work that they did. So, as accountants, we need to go back. We can go back and reverse engineer what we think the taxpayer did, but it wasn't so much that the court said this is the way to do it as much as it analyzed, you know, what was done and concluded that what was done was reasonable.

Do you think that's a fair summary or are there some things you would want to point out?

[00:19:11] **Nicolo Pinoli, CPA:** No, no, you're absolutely right. There was this sweet little table within the ruling, and the table actually shows us all the costs that were at issue, the amount of the cost, and the amount that was included in eligible basis.

And if you dig into the table, the taxpayer included basically about 21% of their total bond issuance costs in calculating eligible basis. The total costs of bond issuance were about \$5 (million) to \$7 million.



Roughly \$1.2 million was included in eligible basis. If you think about it, based on today's 4% tax credit percentage, you're talking about roughly a half a million dollars in tax credits.

And yet, in this case, that 21%, that was a relatively small slice. It's not 50%, 75%, 95%. And yet, when I think about other deals that I've worked on, it's not difficult for me to imagine a fact pattern where 50%, 75%, maybe even nearly 100% of the bond issuance costs could theoretically be included in eligible basis, particularly in a situation where the taxpayer's just using the bonds for construction.

If you dig into that table a little bit and you look at the costs that they were including in eligible basis, they were really costs that were specifically related to the construction period. So things like construction period, letter of credit fees and construction period bank servicing charges. And then there was also sort of this smaller piece which included costs related to, that related both to the construction and to the permanent financing, where only a small slice of those costs was included in eligible basis.

And you're right, from everything I read and everything I could tell from the case, the court basically said, we like your math, go ahead and include everything that you included, because they should be included.

### The Court's Decision

[00:21:09] **Michael Novogradac, CPA**: And maybe you could share for our listeners a little bit more of the findings of the case, maybe digging down a little bit deeper in terms of when you think of what the court ruled, some of the key rulings, because obviously as we're looking at the case, trying to identify what impact it has going forward, we're trying to look and say, well, what did the court rule on versus not rule on?

[00:21:29] **Nicolo Pinoli, CPA**: And I think the headline for me when I, what I focus on is the fact that the court determined that bond issuance costs as a fundamental matter, bond issuance costs, to the extent that they relate to the construction period, they can be included in eligible basis. Now there's lots of other sort of appendages there in terms of what that means and why they reasoned that and how they got there.

And I think there's, over the coming days, weeks and months and years, we'll probably debate the applicability of their reasoning to other similar fact patterns and situations, which is all part of the good fun of being a tax practitioner.

I think if you start digging into the arguments from the parties, the IRS, their arguments were really twofold. One, financing fees are an intangible asset, and intangibles aren't depreciable, and so therefore it's not in eligible basis. And then they went back to their tried and true, well, congressional intent was that these shouldn't be included in eligible basis.

And the court looked at that first argument and said, that's interesting that you think these are an intangible, but you know, we really feel like the financing is an indivisible part of the construction. And so, therefore, to the extent that these costs are allocable to the production period, they should be capitalized to the assets that are being constructed.

And, it was kind of brief, not a lot of real digging into the meat, and getting into the mechanics around how you walk through the process, but really pretty brief. You've got costs, they relate to the construction period, including financing costs like bond issuance costs, those get capitalized to your building.

The second argument, getting to congressional intent, was intriguing, and I'm not an attorney, but as I understand it, when it comes to administrative agencies, and their ability to interpret law, their ability to look through to congressional intent, that ability is only available to the extent that the statute is unclear that there's ambiguity in how the statute is written, or obviously, to the extent that Congress delegates and the details to the regulatory authority.

And I think in this case, the court really looked at it and said the statute isn't unclear. In fact, the statute is quite clear in that it doesn't speak to bond issuance costs needing to be excluded from eligible basis. And therefore, it's inappropriate to actually consider congressional intent.

And so therefore, since Congress didn't write in the statute that bond issuance costs should be excluded, therefore we're going to set aside that argument and find the bond issuance costs really can be included in eligible basis.

[00:24:27] **Michael Novogradac, CPA**: Great. Thank you for that as well. Yeah, I don't want to kind of go into this observation I'm about to make, but I just wanted to put it out there. You know, one of the aspects of the ruling that I found the most intriguing, as you and I have talked about, is the court said that the costs associated with finance and during construction aren't capitalized to a separate category of financing and are allocated to the construction of the property.

It doesn't spend a lot of detail talking about how you determine that allocation methodology, but I did find it interesting that it wasn't treated as a sort of separate asset.

And one of the areas that come to my mind is if you have a construction and permanent loan. We've always taken the position that the construction and permanent loan are treated as one loan. You end up having any costs associated with that capitalized as a separate activity and the portion that you amortize during the construction period is the portion that you would capitalize to eligible basis.

And, the court seems to be suggesting that it's not capitalized as a separate asset and then take the amortization period seems to say you look at the amount that's allocable to the eligible basis and

whether or not the methodology you use for allocable is the same as just putting it together and amortizing it.

That's some of the stuff we need to be unpacking and thinking about going forward. But I'm not going to have you comment on that. We're not going to resolve that now.

[00:26:10] **Nicolo Pinoli, CPA**: We'll be here all day.

### Next Steps for the IRS

[00:26:13] **Michael Novogradac, CPA**: So I'd like you to discuss some of the, your view on the possible steps here going forward from the IRS and the introduction.

Obviously, I talked about how the IRS has to first decide if they're going to appeal or not. And they then have to decide, are they going to acquiesce if they don't appeal and or go to appeals and lose, will they acquiesce to the decision? Any more thoughts you wanted to share with listeners about the next steps?

[00:26:44] **Nicolo Pinoli, CPA**: Sure, and I think sometimes when you get a ruling like this, it can be tempting as professionals playing in this space to sort of spike the football, do a little dance in your face. IRS, we knew you were wrong, and it turns out the court agrees with us.

But I think ultimately this is the first step in potentially several steps yet to come. Certainly, as you mentioned, the IRS has to decide how they're going to respond, and there's a window of time for them to make that decision. Will they appeal? Will they not? Will they announce that they're going to acquiesce? Will they not?

And certainly we could end up even in a bit of a limbo, where they don't appeal, yet they don't acquiesce, and so we're left to guess. What that means, and obviously if the IRS appeals the decision, then it's a sign to all of us in the industry that the IRS wants to keep fighting this issue. They disagree with the ruling fundamentally and that they want to stick to their position that bond issuance costs should not be included in eligible basis.

On the flip side, if the IRS publicly announces we're acquiescing and we're not going to continue to fight this, well, then I think that essentially means that we're probably clear to move forward and broadly, at least to the extent that is appropriate, to include bond issuance costs in eligible basis to the extent that they are due they are eligible to the construction period.

And, obviously, if they don't do either of those things, then we have to guess and we'll see what the IRS chooses to do. Do they audit more taxpayers? Try and fight other cases, maybe with slightly different facts?

And ultimately, I think that also ends up informing other stakeholders. When you think about state agencies, you think about tax credit investors, legal counsel for investors and even the developers themselves, and all of us that work in tax credit land, we're looking at what is the service doing, and then how does that inform our next steps in terms of what it means for deals going forward.

[00:28:54] **Michael Novogradac, CPA**: Yeah, thank you for that. I appreciate particularly you're pointing out we can't spike the football. And when you said that, what reminded me of this tax court case, you know, years ago about the allocation of state historic tax credits in Virginia, and there was a favorable tax court ruling. And people ran around spiking the football, and it ended up being overturned.

And as a consequence, they obviously spiked the football sort of too early. And ended up, and then the appeals decision was upheld, and it definitely changed the way in which state historic tax credit transactions were structured sort of going forward.

This one, I do think when that court came out, and I have prior podcasts to prove it, I said to taxpayers to be cautious that it was a favorable ruling, but it didn't mean that it couldn't potentially be overturned and it dealt with some fact patterns that weren't as strong as you would have liked.

This court case, I will be surprised, and I've been surprised before, but I will be surprised if it were to be overturned because I think it did get to the right answer in terms of bond issuance costs per se, not being includable doesn't seem consistent with the tax code as we've thought for years.

### Possible Impacts on Affordable Rental Housing

Now, let's turn to how we think others in the industry will respond to this decision. And then the Introduction, I mentioned a few of the interested parties in this issue, but I felt that probably makes sense to start with state housing agencies. Because state housing agencies are the ones who you have to go to to get the basis to get to 8609.

So if you could share your thoughts on what's happening, what you think will be happening in the near term at the state housing agency level. I really should say credit allocating agency level, not state housing agency level.

[00:31:11] **Nicolo Pinoli, CPA**: Right, right. Often we use those terms synonymously but, and I think when you look at the statute and various regulatory guidance that's out there, those state agencies, they have very broad authority that's been delegated to them to regulate the low-income housing tax credit incentive in their states.

And with that authority, many of these agencies have their own unique approach to addressing the calculation of eligible basis. For example, lots of states have caps on costs, limitations on various fees and expenses. They provide incentives if you're willing to meet certain limitations or agree to certain calculations. And that's part of the fun of working with these state agencies, and more specifically when it comes to bond issuance costs, many states have forms when it comes to submitting your final cost certification.

These forms have to be completed using their prescribed format, and many states have even taken that specific line for bond issuance costs and blacked out or grayed out that specific line where you might want to include these costs, and obviously that's the state saying no, you can't include these costs in eligible basis.

And so the state would need to update those forms in order to permit taxpayers who are submitting their cost certifications to include those costs in eligible basis. And I think a lot of states will be actively monitoring this IRS appeal. Do they not appeal? Do they acquiesce? Do they not? Some states may be willing to proceed right now and say, well, we have a case and the case said you can include these costs in eligible basis.

So as long as you can get your tax credit accountant to sign the opinion on this report, then maybe we'll let you include it in eligible basis. And so I think there's some uncertainty here and we're still waiting to see how states will respond.

I wouldn't be surprised if some proceed to say, we'll go ahead and let you include it in eligible basis as long as your accountant's OK with it. And others might say let's wait and see. And others might say, you know what? I don't like bond issuance costs any more than the IRS did, so now you're not getting them. We're keeping them out.

But it'll certainly be fascinating because we're looking at 50-plus different agencies, each of which, in theory, could decide on their own how they want to proceed.

[00:33:43] **Michael Novogradac, CPA:** Right. Thank you for that. I mean, I do think state agencies or credit allocation agencies should now allow bond issuance costs to be included on an eligible basis. It was always the right answer. We have a tax credit opinion now that says that. And at the end of the day it'll generate more tax credit equity to a state and allow them to you know, build more housing. And I realize it's not a huge amount, but every little bit helps.

[00:34:10] **Nicolo Pinoli, CPA:** Right, exactly.

[00:34:11] **Michael Novogradac, CPA:** So how about investors? Share some of your thinking as to either how investors will respond and/or how they should be looking at the question.

[00:34:22] **Nicolo Pinoli, CPA**: Sure, sure. And I think some people out there, certainly a lot of my developer clients say, well, the court said it's good, so it should be good, right? And why should the investor care? As long as the court says it's good, then let's include it.

And I think it's important to realize that no different than when you and I go to the grocery store and we go to buy bananas, we're going to check those bananas out before we buy them and stick them in our cart and take them home. You want to make sure these bananas aren't damaged. You want to make sure they're not too green.

And tax credit investors in many ways are doing the same thing when they're underwriting their tax credit investments and when they're essentially making a tax credit equity investment in exchange for those tax credits that are allocated to them by the partnership. They want to make sure that those credits are good credits and that they will be respected and that they're not going to be overturned on audit or in a tax court case.

And so as a result, investors are very, have every right to look at the costs and look at the credits and evaluate whether or not those are good credits that they really feel comfortable paying for. And I think as a result, a lot of ways this is an underwriting exercise for investors. If they're going to agree to include these costs on an eligible basis, some investors may say we want guarantees. We want guarantees from the developer that if something changes, if this case gets overturned, if the IRS fights it, and we lose, then we want guarantees from the developer that they will pay for the loss of these tax credits.

And I think part of the fun is also going to be an issue of size because if we're only talking about \$10,000 in tax credits, then the investor may not care too much. But as soon as you start getting into six, and mid-six and high-six figures, it's real money.

And that tax credit investor suddenly has to worry about what are the implications for my investment and my ability to make sure that I'm made whole if the worst happens. And so I think as a result, if I was a developer, I'd be checking with my tax credit investors and I'd be asking them, well, what do you guys think? And where are you going? Where's your head at these days on bond issuance costs?

And whether we're talking about existing deals that are maybe under development or something where you recently completed it and you're working on the cost cert, even if I'm just thinking about a deal and I'm starting to market that deal to investors, that seems like an important criteria to make sure that you understand whether or not the investors are willing to include bond issuance costs in the calculation of tax credits and therefore ultimately the calculation of tax credit equity. So lots of fun to unpack for investors and developers as they work through it together.

[00:37:19] **Michael Novogradac, CPA**: I definitely think the advice to developers is if you have a transaction that you had the potential to include some portion of bond issuance costs in an eligible basis

and get additional tax credits, then you should be talking to your investor, either the one that's already committed to invest, that's already invested in your transaction or the one that you're talking to about investing in a proposed transaction.

Which really takes me to if I'm a developer and I'm thinking about this court case, and I'm thinking how I apply it to my business, it seems like looking at it in terms of the stages of the development cycle is a reasonable approach in terms of having your buckets.

And let's start with a developer who has a bond deal where they're about to file the partnership return. What should that, at that stage, what should a developer be thinking about?

[00:38:22] **Nicolo Pinoli, CPA:** And I suspect we're talking about not just any return, but maybe the return for the first year of the credit period.

[00:38:28] **Michael Novogradac, CPA:** Yes, indeed. Yeah, that's right. For a property that's been placed in service, so it's going to be the return for the first year that the property is placed in service.

[00:38:36] **Nicolo Pinoli, CPA:** And in that scenario, you really have to be thinking about: How am I calculating eligible basis? And by extension, how am I calculating depreciable basis? And whether or not those bond issuance costs should be included in those calculations.

Part of the fun will also be, gee, do I already have my 8609s? Have I already submitted my final cost certification? Because some of those things may be yet to come, it's not uncommon for them to lag a little bit behind, but certainly, as you're preparing that tax return, that would be first and foremost in my mind is I probably need to be thinking about including bond issuance costs in the calculation of eligible basis, and then really digging deep into that calculation. How much should I include? Coordinating with my investor, coordinating with my accountant to make sure that I'm getting as much as I can.

And this is obviously for deals where it's too late to go back and restructure the deals. Maybe in a minute we'll talk about deals that are earlier stage where I can think about doing something up front to maximize how much I include.

But right now, if I'm filing that return, before I file it, I want to make sure that I'm including as many bond issuance costs as I can in eligible basis because once I file it, it's tough to go back and fix it.

[00:39:54] **Michael Novogradac, CPA:** Yeah, I think I totally agree with you. If if you're working on your 2023 return now, and the project was placed in service in '23, you've got to be thinking about what portion of your bond issuance costs should you be capitalizing and including in eligible basis.

And then similarly, if you're working on a cost certification now, or recently worked on one, had one done, performed, you need to be looking at those cost certifications and thinking, OK, it may have been X'd out that you can't include bond issuance costs on an eligible basis, but maybe now you need to refile that cost certification if the state will let you, and or submit it now, including some portion of bond issuance costs.

And then I think about place of property and service, cost certification, and then I think about getting your 8609s. So maybe, you know, what advice do you have a developer that maybe is now in the process of getting 8609s?

[00:40:52] **Nicolo Pinoli, CPA**: Yeah, well, part of the fun is even if you have 8609s, they can be amended. I've certainly had any number of situations where there have been errors on Form 8609, and we've gone back to the state agency and gotten them to correct those errors and file and issue an amended Form 8609.

This seems like it could certainly be a scenario where you could approach the state agency, even if you have 8609s in hand, and say, you know what? It turns out we miscalculated our eligible basis. Now that there's this ruling, we want to issue a new cost certification and get an amended Form 8609. And depending on the state, hopefully states will be willing to be flexible and work with you here, but certainly there's every possibility of getting an amended Form 8609.

I do think that there's some extra added fun because we're talking about 4% deals here and because we're talking about 4% deals, that means there's no cap on the amount of credits that you can claim. At least no number cap because these are as-of-right credits. As long as you meet the 50% test, there's no limit on how many tax credits your property can claim, unlike, say, on the 9% side, where you receive an allocation of a specific dollar amount, and once you're over that dollar amount, additional eligible basis doesn't generate any additional credits.

On the bond side, additional eligible basis, as long as I'm still meeting the 50% test, absolutely generates additional tax credits, I guess with the one additional caveat that the state agency still has the right to evaluate financial feasibility of the project and limit your credits to the extent that you don't really need them for financial feasibility.

And so I think there's a lot of opportunities at every single stage in that process as you're working on the cost cert, if you've already issued a cost cert, and for that matter, if you've already got 8609s to potentially go back and redo what you've already done so that you can get these costs into basis and claim credits on this higher eligible basis amount.

[00:43:01] **Michael Novogradac, CPA**: And as I said all along, making sure that you talk to your investor.



[00:43:05] **Nicolo Pinoli, CPA:** Absolutely.

[00:43:07] **Michael Novogradac, CPA:** Yeah, don't do this alone. And there was also, you know, a discussion about is this going to actually cause any transaction that previously passed the 50% test but was really close to now fail it? Because now you're capitalizing these costs to eligible basis. And when we talked about it, well, actually go ahead and share your thoughts on that question.

[00:43:30] **Nicolo Pinoli, CPA:** Well, this is good fun. I think in part because I've had to work with clients quite a bit on this issue in the last several years, especially with a lot of bonds being used for construction. You get into this spot where if those costs are allocable to construction, but they're not included in eligible basis, then what am I doing with them?

Am I deducting them? I don't think so. I don't think 263A allows me to deduct them, and if I'm capitalizing them to the building, then my read of the 50% test suggests that the denominator of the 50% test is aggregate basis, which is land plus depreciable basis. And therefore, these costs, bond issuance costs, occupy this unique space where they have the worst of all possible worlds.

They hurt your 50% tests, and yet they don't help you by adding to eligible basis. So for many, many years now, as I've been working on cost certs, this has been part of the bad news I've had to tell my clients. I can tell you they were not happy with that answer. But I stand by the answer that I had and it turns out the tax court agrees with me.

But certainly if, heaven forbid, you were asleep on this issue, you did a cost certification, you looked at your 50% test, you did the math, and for some reason you said bond issuance costs are excluded from eligible basis and so therefore I'm not including them in the denominator then I would go back and take a look at those deals just to see if it makes a difference.

Now, if you were at 53%, 54%, 55%, chances are this isn't going to make a big difference. It might lower you down closer to 50%, but it's probably not going to blow up your deal. But if you were at 50.01%, then this could make a difference. And it's a big deal because if you fail the 50% test, then you lose half your credits right off the top. And obviously that would torpedo your deal from a financial perspective.

So certainly I think for anyone who's sort of waking up to this issue and saying, my goodness, I may have an issue with some of these old 50% tests. I'd say now's a good time to go back and double check, especially for anything done recently, right, in the last few years, I would go back and double check those 50% tests. And then think about if it turns out I may have failed when I didn't think I did, then go back and look and see what remedies do I have to attempt to fix that.

And is the remedy worse than the disease or would I rather just ride it out? And I think that's an important decision for you to make with your investor, with your counsel. I'm certainly not here to advise you other than meeting the 50% test is always the right choice.

[00:46:17] **Michael Novogradac, CPA:** Yes, it is. Yes, it is. So one other area I wanted to ask you about, and then we can bring the podcast toward a close has to do with the opportunities for a transaction that is under construction and/or is still in the planning phases in terms of the ability to maybe restructure the bond issuance in a way that more of the bond issuance costs are allocable to the construction period.

[00:46:48] **Nicolo Pinoli, CPA:** Absolutely. And I think fundamentally, if you're using the bonds for construction, then you ought to be able to include the vast majority, maybe even 100% of the bond issuance costs in eligible basis, at least assuming this ruling continues to be in force and isn't overturned.

And, and I think as a result, if I'm sitting here today planning my deal and I have a choice between, do I keep my bonds or some portion of my bonds around for the next 30 years? Or do I pay them off at construction? I think I might look at that and say, I want to at least look at the option and see, well, what are my, what other perm financing could I get? And how expensive is that? And, and evaluate with and without.

If I just use my bonds for construction, then what does my deal look like? What does my eligible basis look like? If I want to keep a slice of my bonds around on the perm side, then what do I give up in eligible basis in order to do that? Yeah, but maybe I have some cost savings because I don't have an origination fee on a perm loan. And sort of compare apples to apples and decide which one is better financially for my deal in terms of the overall financial total tax credit equity raise, total cost to do my deal.

And I bet for a lot of projects, they're probably going to decide they're probably better off just having the bonds finance construction, certainly from an eligible basis perspective, but often just because perm loan fees are not that expensive. And so as a result, that marginal additional cost, assuming you can go out and get a perm loan from a conventional lender at terms that make sense for you, then often that's, that's a place where I could see a lot of developers ending up subject to the analysis working out.

[00:48:31] **Michael Novogradac, CPA:** Now, I think it's going to be interesting in the weeks and months ahead to think through the various spec patterns that clients have around bond issuances and terms and financing structures and the rest and how this really ends up impacting the design and the choices. It's obviously not a huge number but it's a number that's well worth, you know, some adjustments to your structure from a financial perspective.

## Wrap Up

So thank you, Nicolo. I appreciate you joining me on the podcast. If someone in our audience has listened to the episode, and I think there will be at least one, and they want to know more, what are the next steps that you suggest?

[00:49:21] **Nicolo Pinoli, CPA:** Well, my next steps would be to contact your favorite local Novogradac professional. Certainly, you're welcome to call or email me. I guess we also have a fax number, but not many people outside of the IRS use faxes anymore. And it doesn't have to be me. There are hundreds of other professionals here at Novogradac who work in the LIHTC space.

We'd all be excited to take your call, chat with you about your deal, and discuss the structuring implications for your deal with respect to bond issuance costs.

[00:49:55] **Michael Novogradac, CPA:** All right, thank you for that. And I would just note also that folks should consider joining the Novogradac LIHTC Working Group. That will definitely be a talking point at our next meeting and future meetings as we monitor developments here.

Then also, we do have an affordable housing conference in San Francisco in May, May 2 and 3 at the Grand Hyatt in San Francisco. So we'd love to see you there as well. So, Nicolo, thank you again for joining me for today's discussion. I will include your contact information in today's show notes as well as the links to the court case, the technical advice memorandum, the IRS audit technical guide and I don't know if there's anything else we discussed in the episode, but if there was, we'll include that as well and then in a second, I'll move to my Off-Mike section.

Before I do that, I did want to remind our audience to subscribe to Tax Credit Tuesday on your favorite podcast platforms so you don't miss an episode, and please do give us a review. It helps others find the episode.

## Off-Mike Section

So now, let's turn to our Off-Mike Section. And I don't think I've asked you these questions before, Nicolo, but you've been a guest frequently enough that hopefully I have that right.

And I always like to think back at what I myself wish I knew at the start of my career that I know now. So I'll ask you that question. What's something you know now that you wish you knew at the start of your career?

[00:51:32] **Nicolo Pinoli, CPA:** Well, as a child growing up in the '80s, I got to tell you, sort of with a nod to "Back to the Future," I'm always a little bit wary about messing with the space time continuum. So I would be very cautious in my approach here.

But I think reflecting back, part of the fun here is we work in public accounting, I started my career at a public accounting firm. I'm still here almost 22 years later, and for a lot of people who start in public accounting, you don't know what the future holds.

In a lot of ways, we start off like salmon who head out to sea and only a very small portion end up coming back all those years later to spawn. Very few people who start off in public accounting stay for their whole careers. And I think knowing a little bit more about what the future held, it would have been nice for me to not have to wonder so much and be concerned about, gee, where am I going? Where is this all leading to? Am I really going to do this for the rest of my career? Because the answer is yes. for that. And it's going to be amazing.

[00:52:48] **Michael Novogradac, CPA**: That would definitely be good to have known that. That would have been helpful for me as well.

[00:52:53] **Nicolo Pinoli, CPA**: Right.

[00:52:54] **Michael Novogradac, CPA**: So my second question, which is a popular question regular listeners know that I enjoy reading books and set high goals for my annual reading list.

What's a book that you've read or listened to recently that you'd recommend for our audience? Which would mean that you're also would be recommending for me.

[00:53:16] **Nicolo Pinoli, CPA**: Yeah, actually this comes from a recommendation I received from a good friend of mine, David Altman, who's also recently moved in just down the street from me. So I guess we're neighbors. So hi, David, if you're listening.

And David and I were at one of our conferences in New Orleans a few years ago. Actually, it might have been just a couple of years ago. And we were having a little dinner at Dickey Brennan's Steakhouse. And he mentioned a book he had read that really, I think, shaped his thinking and helped him to understand a lot of things related to so much around agriculture and energy and globalization and our use of plastics and cement and steel and and fertilizer.

And the book is "How the World Really Works," by Václav Smil. And Václav Vaclav Smil, he says in his introduction, well, first he says, look, I don't have an agenda here. I'm not trying to convince you of something. I'm just a scientist, and I'm kind of a weird scientist because I'm not a specialist. I'm really much more of a generalist, and I know a lot about a lot of different stuff, rather than knowing a ton about just one or two little things.

And he then proceeds to sort of walk through all these various areas of how the world really works. And I think for me, better understanding, especially things around agriculture, and energy, and even

housing were incredibly insightful to better understand how we go about solving some of these problems and what, how we address them in the future, and really opened my eyes, and I think for anybody who wants to learn more about these elements, Go ahead and read it, because you will learn a ton.

[00:55:03] **Michael Novogradac, CPA:** Well, thank you for that. That is a great book. And I'll kind of echo your comments, because I can't add to my list, because I have read it. But I will echo David Altman's recommendation, and yours as well, because it really does give you a vision into how the world really works at a, in a way that you don't really distill just through, you know, you know, anyways, across all of it, I found it really insightful.

So, it definitely was, is a book worth reading and we actually recently started these shout outs. So, thank you for giving David Altman a shout out on the podcast and I would be remiss if I didn't also give a shout out to my friend Alan Cohen, an attorney at Holland & Knight along with his partner, James Dawson.

And you might be wondering, why am I giving a shout out to Alan Cohen? He's also a fellow board member of mine at the Affordable Housing Tax Credit Coalition. It's because he and James Dawson were the attorneys representing the taxpayer in the tax court case that we just discussed. So kudos to you, Alan and James, for your victory on behalf of your client in the tax court decision.

[00:56:18] **Nicolo Pinoli, CPA:** And on behalf of the whole industry.

[00:56:21] **Michael Novogradac, CPA:** Yeah, yes, yes, yes indeed. Thank you, Nicolo, and to our listeners, I'm Mike Novogradac, thanks for listening.

## Additional Resources

### Email

[Nicolo Pinoli](#)

### Related Documents

[23rd Chelsea Associates v. Commissioner of Internal Revenue court ruling](#)

[Technical Advice Memorandum 200043015: Eligible Basis](#)

[Audit Technique Guide IRC 42, Low-Income Housing Credit](#)

### Working Group

[LIHTC Working Group](#)

### Conference

[Novogradac 2024 Affordable Housing Conference](#)