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Upcoming IRS Guidance Hangs over HTC Community

BRAD STANHOPE, ASSIGNMENT EDITOR

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Pardon those in the historic tax credit (HTC) community if they feel battered. "There's never been a period in my memory where projects struggled to find investors," said John Leith Tetrault, chairman of the Historic Tax Credit Coalition (HTCC). "Deals are staying on the market much longer than they used to." Leith Tetrault says a combination of a landmark court ruling, the issuance of a revenue procedure and uncertainty about how to treat 50(d) income generated by the use of the Master Tenant structure have slowed the industry over the past few years.

That may change for the better. The third in a series of HTC dominoes may fall this summer, when it is hoped the Internal Revenue Service (IRS) will issue guidance on Section 50(d) income. That guidance follows the 2012 federal appeals court ruling on the Historic Boardwalk Hall (HBH) case and the subsequent 2013 IRS Revenue Procedure 2014-12 that provided guidance on how investors should be tied to the underlying economics of the transactions in order to be respected as a partner. "[The market is] not fully back to the pre-Historic Boardwalk Hall volume," Leith Tetrault said. "We are past concerns about HBH and the revenue procedure. Any further impact on pricing or investor demand will depend on what guidance the IRS provides on 50(d)."

To fully understand where the historic market is now, you need to go back to the first critical event in 2012—the U.S. Court of Appeals ruling on the Historic Boardwalk Hall case.

Historic Boardwalk Hall Fallout

When the U.S. Court of Appeals for the 3rd Circuit issued its Historic Boardwalk Hall case ruling in August 2012, the HTC world took notice. The court ruled that investors in a HTC development must have a clear stake in the economic outcome of the development–specifically that Pitney Bowes, which invested $16.4 million in the Atlantic City, N.J. conference center, was not entitled to the HTCs from the property because it didn't have a clear stake in the development's success for failure. That ruling slowed the market and led to the next big event.

"The Boardwalk Hall ruling was the impetus for Revenue Procedure 2014-12," said Thomas Boccia, CPA, a partner in Novogradac & Company LLP's office in Cleveland. "When 'Boardwalk' came out, the industry came to a screeching halt. Then it slowly dug itself out of the backlog and people became comfortable and it started moving along." Boccia said a subsequent IRS Chief Counsel Memorandum (CCM) in early 2013 made everyone take a step back as it cast doubt on where the IRS would draw the line on how much risk investors were expected to bear in HTC deals in order to be respected as partners. "The market kind of slowed," Boccia said. "People were doing deals, but not at the same pace. They were trying to guess what the guidance would be. There was a lot of dialogue about that."

Revenue Procedure 2014-12 and 50(d)

Finally, the IRS issued Revenue Procedure 2014-12 late in 2013. It provides safe harbor rules under which the IRS won't challenge a partnership's allocation of HTCs, although some of the requirements were at first unclear. "People were responding and trying to figure out how to apply it," said Leigh Ann Smith, a senior vice president of tax credit equity investments at Bank of America Merrill Lynch. "We hoped

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the revenue procedure would be a recipe, but it was just a list of ingredients. Each organization had to come up with their own recipe using those ingredients, so 2014 was the year of responding to Revenue Procedure 2014-12 and adapting and adjusting to 50(d)," Smith said. "It was a hard year for doing deals. Some investors dropped out."

Leith Tetrault said it was no surprise that the revenue ruling had a major effect, since it was the first significant guidance issued by the IRS on the HTC since its inception. Smith agreed, saying, "In previous years, this was a fairly stable market. There was a consensus on how transactions were constructed, but the Boardwalk case disrupted the market, then the revenue procedure disrupted it in a positive way. I feel like the new approach is consistent across most of the industry, which reflects a collaborative process."

Smith said her organization has remained active in HTC investments, but, "at the same time, a significant issue hasn't been addressed and it became the next big thing," Smith said. "It's like we're in a giant game of whack-a-mole. [Next up is] the treatment of 50(d) income–that's been the headwind facing the industry. There's uncertainty." Smith said the HTTC met with representatives of the IRS and the Department of the Treasury and there was hope that guidance would be issued by June 30, the end of the fiscal year 2015 (FY2015) Priority Guidance period. "It has the potential to have a chilling effect," Smith said. "Not yet, though."

Current Market, Investor Shift

While the HTC market waits for the 50(d) guidance, deals continue to be done. "The industry is kind of settling in and moving on," Boccia said. "They're trying to close on transactions and you can see momentum beginning to pick up." Boccia also said the absence of some larger investors in the industry has created a positive side effect: "It opened the market to other investors," he said. "The syndicators had to find other investors and it was sink or swim. I believe it brought investors into the marketplace who wouldn't have been approached otherwise."

Credit Prices

Leith Tetrault said the value of ownership interests in an HTC transaction vary greatly based on what assumptions an investor makes in anticipation of 50(d) guidance. "We are seeing LLC ownership interests going for $1 down to $0.90 on the tax credit dollar, depending on how you are reading the tea leaves." Smith agreed, citing a range of the mid-80-cents range to $1.15, depending on whether the structure assumes any 50(d) income. Boccia said the value of ownership interests varies, as always, on the size of the deal. He said he sees developments worth $1 million to $3 million where investors buy into their ownership interests averaging about 75 cents to 95 cents per credit dollar. Those in the $3 million to $5 million range typically bring in 95 cents to $1 per credit dollar and those for more than $5 million get about $1.05 per credit dollar.

"Another trend is going back to single-tier structure instead of master-lease structures," Boccia said. "I wouldn't say it's a groundswell, but it's because of 50(d) and other reasons."

Effect of Tax Reform

While other tax credit investments have been affected by Congressional action, the HTC world is largely unimpeded. "Because the HTC is part of the permanent code, legislative uncertainty isn't hurting it, but tax reform uncertainty might be affecting deals," Boccia said. "It's probably kept some investors out, but there are too many other factors in a historic deal." But with November's Republican wins in the Congress, there is increased likelihood of reform, which could affect the market. "We haven't even seen the [tax reform} proposals," Smith said. "When it gets to the point that proposals are on the table, it will be different."

Now many HTC investors continue to be patient. "Deals don't come overnight," Boccia said. "We're getting some commonality about how deals need to be structured." ❖

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CONTACT

CORRESPONDENCE AND EDITORIAL SUBMISSIONS
Alex Ruiz
alex.ruiz@novoco.com
415.356.8088

ADVERTISING INQUIRIES
Tyler Perrotta
tyler.perrotta@novoco.com
415.356.8062

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