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Considerations when Twinning NMTC and HTC

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Question: What should a project consider when twinning new markets tax credits (NMTCs) and historic tax credits (HTCs) in a transaction?

Answer: There are many factors to consider when setting up a financing structure using both the NMTC program and the HTC program.

One key difference in the programs is the compliance period. The NMTC program has a seven-year compliance period, beginning on the date a community development entity (CDE) receives a qualified equity investment (QEI). The HTC program has a five-year compliance period, beginning on the date a qualified rehabilitated building is placed in service. Developments looking into a financing structuring twinning NMTC and HTC should be aware of the potential gap between the compliance periods.

A project entity that receives NMTC financing is required to meet the requirements as a qualified active low-income community business (QALICB) under Internal Revenue Code (IRC) Section 45D(d)(2) and Treasury Regulation (Treas. Reg.) Section 1.45D-1(d)(4). A couple of key requirements a QALICB is required to meet are:

- the project is required to be located with a low-income census tract, and
- the project cannot be deemed a residential rental property under IRC Section 168(e)(2)(A). The HTC program does not have such requirements; therefore, projects looking to use both NMTC and HTC financing should consider the restrictions.

In recent years, the HTC program has undergone quite a few significant changes. In late 2013, Revenue Procedure (Rev. Proc.) 2014-12 was issued. In July 2016, the Internal Revenue Service (IRS) published temporary regulations regarding IRC Section 50(d) income. Most recently, in December 2017, tax reform legislation was signed, which provided significant changes to the HTC program.

Rev. Proc. 2014-12 establishes a safe harbor in which the IRS will not challenge the allocation of HTCs if the transaction is structured in accordance with the revenue procedure. Rev. Proc. 2014-12 is intended to provide the industry with more predictability regarding the allocation of HTC. Upon the initial release of Rev. Proc. 2014-12, there was a lot of speculation and uncertainty regarding how twinned

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HTC and NMTC transactions would be impacted, but the industry has become more adept and comfortable in structuring a twinned HTC and NMTC transaction to satisfy the safe harbor provisions in Rev. Proc. 2014-12.

A common twinned structure in the post-Rev. Proc. 2014-12 era has an investor separating its HTC equity and NMTC equity. The NMTC equity is contributed into the investment fund, which typically receives a leverage loan from the landlord entity's managing member. Combining the leverage loan and NMTC equity proceeds, the proceeds flow through the NMTC structure to the landlord entity. The HTC equity is contributed into the master tenant entity for a 99 percent ownership interest, with the remaining 1 percent ownership interest held by the master tenant entity's managing member. The HTC equity is then typically contributed by the master tenant entity into the landlord entity.

In July 2016, the IRS published temporary regulations that provide guidance regarding the income inclusion rules under IRC Section 50(d), which were subsequently finalized in July 2019. The final regulations indicate that IRC Section 50(d) income is a partner item rather than a partnership item, that IRC Section 50(d) income goes to the partner in the lessee that used the tax credits and that partners are not entitled to increase their bases in their partnership interests as a result of the IRC Section 50(d) income inclusion.

Lastly, the tax reform legislation that was passed in December 2017 resulted in significant changes to the HTC program. The 10 percent rehabilitation tax credit was eliminated. Additionally, the 20 percent HTC was modified. Under the prior law, when qualified rehabilitation expenditures (QREs) with respect to any qualified rehabilitated building were placed in service, HTCs were claimed in full. However, under the new law, HTCs will be claimed ratably over five years. Specifically, the ratable share of HTCs for any taxable year during the five-year period, beginning in the taxable year in which the qualified rehabilitated building is placed in service, is the amount equal to 20 percent of the HTCs with respect to the qualified rehabilitated building.

Projects should consider the factors and changes discussed as they are looking into using both NMTC and HTC programs in their development. Novogradac is highly experienced in this type of transaction and in navigating through these difficult tax areas. Please contact your Novogradac tax adviser with any questions. ❖

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