NOVOGRADAC TAX CREDIT TUESDAY PODCAST

Summary: August 18, 2020

In this week's Tax Credit Tuesday podcast, Michael J. Novogradac, CPA shares an update on negotiations over COVID-19 relief legislation, as well as how tax incentives fit into the discussion. Then, he talks about details of former Vice President Joe Biden's tax proposals, and what his proposals could mean for investments in tax incentives next year and beyond, if Biden wins this election. He wraps up with discussion of the latest qualified equity investment issuance report from the CDFI Fund, including the amount of new markets tax credit allocation authority that remains to be issued.

Summaries of each topic:

GENERAL NEWS

COVID-19 Relief Plan

Negotiations appear to continue to be at a standstill among the House, Senate and White House over the next phase of COVID-19 relief.

In last week's podcast, I outlined several areas of disagreement. Those areas include overall cost of the next COVID-19 relief package, the amount of weekly unemployment insurance to provide, and the levels of aid to state and local governments. These issues continue to be sticking points.

After more than two weeks of negotiations, members of Congress have left Washington for their August recess and are not scheduled to return until after Labor Day. That said, if a deal is somehow reached during the recess, congressional leaders can call members back to Washington for a vote.

Also worth noting, Politico reported yesterday that Senate Republicans are planning to introduce a "skinny" coronavirus relief bill today. The bill is expected to include $300 in additional weekly federal unemployment benefits until Dec. 27, an additional round of Paycheck Protection Program loans, an additional $10 billion for the U.S. Postal Service, and liability protections.

Two GOP sources, according to politico, said that the "skinny" coronavirus bill could be attached to a continuing resolution to keep the government funded past a Sept. 30 deadline. Congress has until Sept. 30 to keep the government funded and avoid a shutdown.

While these various negotiations are on hold, so are discussions of tax credit provisions that could help with economic recovery, such as establishing a minimum 4 percent low-income housing tax credit rate, extending the new markets tax credit, and monetizing general business tax credits.

I'll continue to provide updates on these issues in upcoming podcasts and I'll tweet them as well.

Democrat Tax Plan

On the election front, the Democratic National Convention began Monday, yesterday, and continues through Thursday.

Joe Biden will be formally nominated at the Democratic candidate for president of the United States today, Tuesday, and is scheduled to give his acceptance speech on Thursday night. That will be a day after his running mate for vice president Kamala Harris is scheduled to give her acceptance speech. With all that happening, this seems like a good time to look at some of the key tax policies that Biden supports.

Biden has rolled out several provisions as part of his Build Back Better plan. There's a lot to tackle, but we'll just focus on a few items here. Starting with corporate taxes.

Vice President Biden proposes to increase the corporate tax rate from 21 percent to 28 percent. As you recall, that corporate tax rate was at 35 percent before the 2017 tax reform bill, so Biden's proposal would return the rate halfway to the previous rate. If Biden is elected and his 28% corporate tax rate plan is enacted, there would obviously be some significant effects on tax credit equity pricing.

But in order to increase the corporate tax rate, a President Joe Biden would likely need a Democratic-controlled Senate and House. The House is currently controlled by Democrats and is widely expected to say Democratic after the election.

The Senate, however, is currently controlled by Republicans, but some of the latest predictions give the Democrats at least a 50-50 chance to take the Senate in November. If Democrats control the House, Senate and White House, a higher corporate tax rate appears likely.

At first glance, a higher corporate tax rate would increase corporations' appetite for various tax credit provisions. Specifically, that would include the low-income housing tax credit, new markets tax credit, historic tax credit and renewable energy tax credits. If corporations have more tax liability, they likely have more interest in tax credits, which can be used to reduce that liability. This additional interest in tax credits, all other things being equal, would mean higher tax credit equity pricing. But, all other things are not equal.

For example, another proposal from Biden is for a 15 percent minimum tax on book profits for corporations with at least $100 million in annual income. Book profits are the annual reported net income. This is somewhat similar to the alternative minimum tax for individuals and the former alternative minimum tax for corporations that was repealed. Now this comes into play because the tax on book profits would set a minimum amount of tax a corporation would have to pay. It is unclear, if such a minimum tax, if enacted, could be offset by tax credits. If the minimum tax could not be offset by tax credits, then the minimum tax could serve to damper corporate investor interest in tax credits.

Also, Biden supports legislation to expand the low-income housing tax credit and new markets tax credit. Biden also supports increasing the historic tax credit percentage temporarily and restoring and expanding renewable energy tax credits. If those tax credit expansions happen, there would be more credits available, which could <u>also</u> offset the upward pressure on tax credit equity pricing that greater corporate tax liability could cause.

We should also note, as we witnessed in 2017, the economic value of the low-income housing tax credit is greater at higher corporate tax rates. So a rise in the corporate tax rate, increases the economic value of the low-income housing tax credit. The impact of the corporate tax rate on new markets tax credits, the historic tax credit and renewable energy tax credits is more muted.

The point is that under the Biden tax plan, there would be significantly more corporate taxes that could be offset with tax credits. But there also could be a minimum tax and more supply tax credits. On balance, you'd expect equity pricing to rise, just a question of how much, and its also subject to all the other variables as in how's the economy doing and the rest, so it's very difficult to predict what kind of impact all of this would have.

Another area I wanted to highlight in Biden's tax proposals is the taxation of capital gains. Biden proposes to tax capital gains of individuals at the same rate as ordinary income.

Corporations do not have a lower capital gains tax rate, which means the Biden plan to increase the corporate tax rate from 21 percent to 28 percent also increases the corporate tax rate on capital gains. For individuals, under Biden's plan, top tax rate on capital gains and ordinary income would be 39.6 percent for high-income earners.

Biden's plan doesn't define who are high-income earners, but the current top rate is for individuals who make more than $518,000 annually and couples who earn more than $622,000 annually is 37 percent, so he might be thinking of keeping the same threshold or higher. Capital gains are currently taxed at 23.8 percent, so raising it to 39.6 percent would be a major increase.

Higher tax rates on capital gains affects the opportunity zones incentive. Individuals and corporations receive tax incentives if they invest capital gains in opportunity zones. The incentives include the deferral of capital gains income and a reduction in that reported gain if it meets certain holding period requirements.

In 2020 and 2021, individuals and corporations may be less likely to invest in OZs and defer capital gains, for fear that such deferred capital gains would be subject to higher tax rates in 2026. On the other hand, investors in OZs can exclude from income any appreciation in their investments in OZs that they hold for 10 years. Higher capital gains taxes at the end of that 10-year period, would increase the value of that deferral.

On balance, it remains to be seen how the potential for higher capital gains taxes in 2026 combined with the potential greater benefit of the 10-year deferral how those two balance out in terms of low-income investment in opportunity zones over the next two years.

There are many more details and moving pieces to Biden's tax proposals that, if enacted, would affect tax incentive markets next year and in the years to come, as well as the broader economic environment that would affect the tax incentive markets.

I am working on a larger analytical piece that we'll be publishing at Novogradac in the next couple of months.

For my Washington Wire column in the September issue of the Novogradac Journal of Tax Credits will focus on what we might see in terms of tax policy in 2021 and beyond if the Democrats take the Senate, keep the House and Biden wins the presidency.

In other words, what could happen in terms of tax policy in the case of a Democratic sweep? You can read that column by subscribing to the Novogradac Journal of Tax Credits. I'll include a subscription link in today's show notes and tweet it out as well. I'll also talk more about tax incentive issues in the context of the election on this podcast in the coming weeks.

Other News

Shifting gears to other news, last week on Monday to be exact, the CDFI Fund released the August QEI report, that's the new markets tax credit qualified equity investment report.

According to the August QEI report, the cumulative amount of finalized new markets tax credit investment is more than $55.7 billion through 16 allocation rounds. That's about $158 million more in equity investments finalized since the CDFI Fund's July QEI report.

The amount of new markets tax credits allocation authority remaining to be allocated is around $5.3 billion, although much of this amount is likely already committed. This $5.3 billion total includes the 2019 allocations that were announced July 15 at an amount of $3.5 billion.

As a reminder, we expect the 2020 round of the new markets tax credit to open later this summer, or early this fall. If you need assistance preparing your new markets tax credit application, reach out to a Novogradac expert near you.

Related Resources

Democrat Tax Plan

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