NOVOGRADAC TAX CREDIT TUESDAY PODCAST

Summary: August 25, 2020

In this week's Tax Credit Tuesday podcast, Michael J. Novogradac, CPA, discusses a report from the White House Council of Economic Advisers on the economic impact of the opportunity zones incentive. Then, he talks about a U.S District Court ruling in Hawaii that addressed the ability of a state allocating agency to terminate extended-use agreements under the qualified contract process. Next, he shares updates on COVID-19 relief legislation in Congress, and discusses President Donald Trump's tax proposals if he is re-elected in November. He wraps up with discussion of low-income housing tax credit compliance issues that were not addressed in IRS Notice 2020-53.

Summaries of each topic:

GENERAL NEWS

OZ Report

Big news dropped Monday when the White House Council of Economic Advisers released a report on the economic impact of the opportunity zones incentive. The Council of Economic Advisers is charged with offering the president objective advice on domestic and international economic policy.

The headline news from the report? The CEA, as the council is called, estimates that qualified opportunity funds raised $75 billion in private capital by the end of 2019. The report also revealed that Treasury estimates, based on tax filings, in 2018, about 1,500 opportunity funds were formed. The CEA report includes an estimate that by the end of 2019, over 3,000 opportunity funds had formed and raised capital.

The report says most of that would not have occurred in opportunity zones without the incentive. As an example, the report estimated that private equity investment in businesses in opportunity zones grew 29 percent compared to similar businesses. By that, the report means businesses in eligible communities that were not designated as opportunity zones.

The CEA report used two samples to make its capital raised estimate. First is data from the Securities and Exchange Commission, which tracks qualified opportunity funds as securities. The second source is the Novogradac Qualified Opportunity Fund List. The CEA report highlights how closely the Novogradac list and the SEC list correlate in tracking the growth of opportunity funds and the rate of increase in capital raised.

By the way, we do expect to release updated data from the Novogradac Opportunity Funds list within the next week or so. I will of course tweet that information when it's available.

Getting back to the CEA report, the report discussed the cost of the OZ incentive to the federal government. The report says that the OZ incentive has a direct effect of 15 cents in forgone federal revenue. The forgone revenues, the 15 cents per dollar of capital raised stems from three key components: One is the deferment on the capital gains tax on the original gain, the reduction in taxes on the original gains when paid, and third, the lack of taxes on the gains earned while invested in the Qualified Opportunity Fund.

However, the report also observes that the OZ incentive could be revenue neutral. That's because the economic growth spurred in low-income communities could offset the reduced taxes received on capital gains.

In a related announcement, President Donald Trump's campaign said the president would expand opportunity zones if he is re-elected. We'll talk more about the tax implications of a second Trump term in a little bit.

There's a link to the CEA report in today's show notes and I'll tweet the link out. Also, we'll be talking about this report at the upcoming Novogradac 2020 Opportunity Zones Fall Virtual Conference. That conference is Oct. 22-23. The link to register is in today's show notes and I'll tweet out the link as well.

Hawaii Extended-Use Agreements Case

Now, let's discuss our second breaking news item. An important legal decision affecting low-income housing tax credit properties and the qualified contract process. Specifically, the U.S. District Court for Hawaii issued a ruling earlier this month that addressed the ability of a state allocating agency to terminate extended-use agreements under the qualified contract process.

Specifically, the court ruled that a termination of the extended-use agreement in connection with the qualified contract process was <u>not</u> valid. The court ruled that in this particular case, the extended-use agreement would continue to apply to the property. The case involved a low-income housing tax credit property on Maui.

As that property neared the end of its 15-year LIHTC compliance period, the property owner submitted a qualified contract application to the state agency. When no buyer could be found within 12 months, the state credit allocating agency terminated the extended-use agreement. However, four tenants sued, alleging that the termination violated the recorded extended use agreement.

As you know, the qualified contract process begins when a low-income housing tax credit property owner submits a written request to the state credit agency to find a buyer to purchase the property for a specified price. If a buyer is found, the property will continue to be operated as low-income housing. That request can be made as early as when the building begins Year 15 of the compliance period. However, if the state <u>can't</u> find a qualified buyer within one year, the affordability restrictions are lifted.

In this particular case, at the time the original regulatory agreement was signed, the owner of the Maui property agreed to keep the property affordable for 50-plus years. However, as the property neared the end of the initial 15-year compliance period, the owner sought to terminate the extended-use period through the qualified contract process. The state agreed the owner was eligible and accepted the request. A year later, because a new owner could not be found, the state released the owner from the affordability restrictions, effective August 2019. That's when the residents sued.

Ultimately, the court ruled that the qualified contract process should <u>never</u> have been available to the property owner. The court noted that the recorded extended use agreement did not include a reference to the qualified contract exception as a means to terminate the agreement. The court noted that a sub-clause in Section 42 allows allocating agencies to require more stringent affordability requirements be applied to properties. The more stringent affordability requirements effectively permit the state to disallow property owners from ever having the right to pursue the qualified contract process.

The court noted that several mechanisms for terminating the extended-use agreement, such as foreclosure, that were mentioned in this specific extended-use agreement that was recorded. But the qualified contract process was <u>not</u> mentioned in the agreement. The District Court concluded that because the extended-use agreement didn't include any mention of the ability to terminate the affordability restrictions by use of the qualified contract process, the property owner had effectively waived any right to such a termination.

While the Hawaii case had specific issues that may not be at play everywhere, it's a good reminder that a qualified contract exit to the compliance period isn't always available. It also is a reminder that simply because the allocating agency terminates the agreement, doesn't mean that tenants cannot sue, and potentially overturn the termination of the extended-use agreement.

If you're coming up on Year 15 or are considering a qualified contract exit, now is a good time to make sure that the property is eligible. Please contact my partner Nicolo Pinoli in our Portland, Ore., office for further assistance.

COVID-19 Relief Legislation

Now let's turn to the latest news on federal COVID-19 relief legislation.

The past several weeks involved a lot of discussion and the introduction of a Senate bill. But, there has been no action on the legislation. It's not clear if this week will be any different.

Let's review where we are. In May, House Democrats passed a bill that included $3.4 trillion in aid. That was the HEROES Act. Senate Republicans released their $1 trillion package in July. The Senate bill was called the HEALS Act, which hasn't passed the Senate yet. You basically have HEROES versus HEALS.

Negotiations have been at a standstill since July. During that time, the extra $600 per week in unemployment insurance expired, as did the national eviction moratorium. Some of the key issues still in dispute include: the overall price tag, the amount of extra unemployment insurance, and how much aid goes to state and local governments.

Last week, Senate Republicans did start circulating a discussion draft of a so-called skinny relief bill. The bill has not been introduced. What was circulated was a draft of potential legislation to see how Republican senators feel about it. Basically, surveying the Republican caucus in the Senate. The bill may still be introduced. It's also possible that provisions of the legislation could be added to a continuing resolution to keep the government funded past Sept. 30.

The skinny relief bill discussion draft does <u>not</u> include any of the tax provisions we've discussed over the past few months, such as: a minimum 4 percent low-income housing tax credit rate, an extension of the new markets tax credit, and other provisions.

The Republican skinny relief bill though <u>does</u> include: an extra $300 weekly in unemployment insurance, $100 billion for education, and $10 billion for the United States Postal Service.

I should also note, the House on Saturday approved legislation to give the USPS an additional $25 billion in funding, so that's another item to negotiate with the Republicans.

We'll keep an eye on this as negotiations continue and update you when there's movement. Please follow me on Twitter for any breaking news.

Trump Tax Plan

Now, let's turn to something that we know is happening this week.

Last week, Democrats held their national convention and nominated Joe Biden as their presidential candidate. We discussed Biden's tax plan last week. And we mentioned Trump's proposal for opportunity zones earlier in the podcast.

The Republican national convention began Monday and continues through Thursday. So, let's take a brief look at the tax plans for President Trump, who will accept the nomination by his party Thursday night. As the incumbent, Trump does not have a major list of tax policies. Four years ago, of course, he campaigned with a major focus on tax cuts. At the end of his first year in office, Republicans passed legislation doing that—the legislation that created opportunity zones.

This time, things are different. Trump has talked occasionally since 2017 about a second tax reform bill, but has provided few concrete details. The individual provisions of the 2017 tax bill will expire in 2026. Trump has pledged to make those provisions permanent as part of his second-term agenda.

There are a couple of other items that he's discussed frequently in recent weeks. One has been part of his discussion of COVID-19 relief legislation: Cutting payroll taxes.

Trump did issue an executive order earlier this month to defer payroll taxes. Payroll taxes, of course, pay for Social Security and Medicare. Trump has suggested he would seek a permanent repeal of payroll taxes if he wins a second term, although his press secretary said Trump was talking only about forgiving the payroll taxes he deferred. However, Trump has said multiple times that he wants to end the payroll tax.

The other tax item that Trump has discussed is an overall reduction in the capital gains tax to 15 percent. As of now, the capital gains tax is 15 percent for married taxpayers who earn $80,000 to $496,600. The top capital gains tax rate is 23.8 percent for taxpayers who earn more than that amount. In other words, those married taxpayers making about $500,000 a year or more. That rate is 20 percent plus the 3.8 percent addition in general.

Trump said he wants to cut the overall rate to 15 percent. Trump has suggested he may issue an executive order to cut the capital gains tax rate, but many Democrats say that oversteps the authority of the president.

In some ways, this may be a moot point. Trump trails Biden in the polls and even if he wins in November, he would need Congressional support to pass tax legislation. The House of Representatives is expected to remain controlled by Democrats. The Senate is considered at best a toss-up for Republicans, which means it would be difficult for Trump to get major tax legislation through Congress. He would need control of the House and the Senate.

Trump has previously said he will release a middle-income tax cut proposal, but he hasn't done so yet. We'll keep watching for a Trump second-term agenda and will report on it if a plan is released. As I mentioned last week, my column in the September issue of the Novogradac Journal of Tax Credits addresses Biden's tax-related proposals and how the Senate would look under Democrat control.

We’re also working on a special report on the potential effects of a Democratic sweep of the House, Senate and presidency in November. The special report will include a discussion of: Where tax legislation would fall in Democratic priorities, the likelihood of affordable housing and community development legislation passing, how tax legislation could affect equity pricing for existing tax incentives, and what a Biden administration might do with government appropriations and regulatory issues.

That special report will be released in September. The report will be free to clients. We’ll talk more about the special report as it gets nearer to release. There’s a link to subscribe to the Novogradac Journal of Tax Credits in today’s show notes.

LIHTC Compliance Issues

Next, let’s talk about low-income housing tax credit property compliance.

You may recall that the IRS released Notice 2020-53 in July. This notice provides relief for low-income housing tax credit property owners, managers and tenants affected by the COVID-19 pandemic.

Here’s a summary of the notice: First, the Notice provides extensions for several deadlines, including: the 10 percent test deadline, the 24-month minimum rehabilitation expenditure period, and others. Second, Notice 2020-53 waived tenant income recertifications on mixed-income projects. The notice did not waive initial tenant income certifications. Third, the notice clarified that closing a common area or amenity due to the COVID-19 pandemic does not cause a reduction of eligible basis. And fourth, the notice clarified that medical personnel or other essential workers qualify as displaced persons under IRS Revenue Procedures 2014-49 and 2014-50.

While Notice 2020-53 provided relief in these four areas, there were property compliance areas in which the notice provided little to no guidance.

My colleague Stephanie Naquin wrote an article for the September issue of the Novogradac Journal of Tax Credits. In the article, Stephanie highlights property compliance guidance that is still needed for low-income housing tax credit owners and managers.

Specifically, guidance that was not included in the notice includes: Whether or not annual income recertification waivers also waive annual student status verifications. Also not included, whether certain questions in the annual owner certification are waived, as well as whether or not additional extensions are allowed for noncompliance correction periods.

For starters, Novogradac recommends that you continue practicing safe and diligent property compliance procedures, using the relief in the notice as necessary. For example, it’s a good idea to continue income recertifications. That is if circumstances permit. If recertifications are not possible due to COVID-19, use the relief in the notice.

Please also note that Notice 2020-53 waived income recertifications for mixed-income properties. However, state agencies may still require income recertifications. Contact your state agency if you need relief or guidance for your annual income recertifications.

Along with income recertifications, it is also a good idea to get full-time student status verifications. Even if you are not doing annual income recertifications, you need to verify full-time student status for tenants in order to avoid noncompliance for units entirely occupied by full-time students.

Also, not completing annual income recertifications can make it difficult for owners to do annual owner certifications. Without income certifications, owners cannot verify such things as: whether the property meets the applicable minimum set-aside, that there has been no change in the applicable fraction of a building, that annual income certification was performed for each low-income tenant, and if a tenant became over-income, then the next-available-unit rule was followed.

Lastly, Notice 2020-53 did not provide specific guidance or relief for the noncompliance correction period. When an allocating agency identifies noncompliance, the owner typically has a 90-day correction period. That period can be extended up to six months with good cause.

However, depending on the timing of noncompliance and the six-month correction period, it could be necessary for another extension to correct noncompliance. That's especially true for owners or managers who face challenges adjusting to COVID-19, both at their properties and at their management companies. Those difficulties are amplified by employees working more remotely and for certain tenant populations, such as seniors.

We are hopeful that the IRS will release more specific guidance as the pandemic continues and as property owners experience more complications. Again, we at Novogradac recommend diligent property compliance procedures, to the greatest extent possible. Reach out to your state agency if you are a property owner seeking relief from income recertifications or other property compliance procedures due to COVID-19-related complications.

If you need help with income or owner certifications, Novogradac is here to help. We have experts in every state who are ready to help you. And, if you'd like to read Stephanie Naquin's article in the September issue, make sure you're subscribed to the Journal. As I said earlier, there's a link to subscribe in today's show notes.

Related Resources

OZ Report

The Impact of Opportunity Zones: An Initial Assessment

Novogradac 2020 Opportunity Zones Virtual Conference

Trump Tax Plan

Subscribe to the Novogradac Journal of Tax Credits

Hawaii Qualified Contract Process Lawsuit

Michael Tuttle et al vs. Front Street Affordable Housing Partners

Property Compliance Issues

Notice 2020-53

Novogradac 2020 LIHTC Property Management Handbook

Order the Handbook