Global Minimum Tax

More than 130 nations are working toward an agreement to ensure that multinational corporations pay a minimum level of income taxes. The second of two "pillars" in this framework would ensure that the world's largest and most profitable companies are taxed in each jurisdiction in which they do business at an effective rate of 15%. Since any rate less than 15% would make the corporation subject to a top-up tax to reach that level, there are concerns about how U.S. general business credits–including the low-income housing tax credit (LIHTC), historic tax credit (HTC), new markets tax credit (NMTC) and renewable energy tax credits (RETCs)–would contribute to lowering effective tax rates below 15%. In this podcast, Michael Novogradac, CPA, and Novogradac partner Brad Elphick, CPA, discuss the global minimum tax and issues associated with it concerning tax credit equity. They discuss how and when potential guidance would affect tax equity investments, potential approaches to mitigate the damage to tax equity investments, how the equity investment exclusion approach would work, how the proportional amortization and HLBV approaches fit, the joint venture rule and portfolio shareholdings. The conclude with the next steps that stakeholders in community development tax incentives should take.

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Transcript

[00:00:10] **Michael Novogradac, CPA:** Hello. I'm Michael Novogradac. And this is Tax Credit Tuesday. This is the June 14, 2022, podcast.

In today's podcast, we're going to discuss the potential enactment of a global minimum tax and how that could affect equity pricing of community development tax credits. Now, those of you who listened to last week's podcast on new markets tax credits and target populations might be thinking that this podcast was supposed to be about lease accounting. Well, we pushed back the lease accounting podcast one week so we can discuss the global minimum tax this week and its potentially far-reaching adverse consequences.

Overview

Many listeners to this podcast may not be aware of international efforts to ensure major global companies pay a minimum level of income taxes. Still others likely have heard of the issue, but are unclear of the potential sizable damaging adverse effects on community development investing. I'll begin the podcast by providing an overview of international efforts to enact a global minimum tax, then we'll get into more discussion with my partner, Brad Elphick, from our Atlanta office, and the steps we are taking to attempt to mitigate the potential adverse effects.

The global minimum tax proposal is being led by the Organization of Economic Cooperation Development or OECD, and as part of a two-prong plan, a plan that more than 130 countries have agreed in principle to support. One prong of the plan, which the document calls a pillar, would allow governments to tax the world's largest and most profitable firms based on where their goods and services are sold rather than where they are based.

The second pillar is what we're going to discuss today. The second pillar, or Pillar II, would create a system to ensure that large multinational enterprises pay at least a 15% minimum tax on book income. Now, the enforcement mechanism is a unique and creative idea. To ensure that all countries are incented to adopt a 15% minimum tax, the proposal includes what is referred to as a top-up tax. Under the proposal, to the extent that a company has income sourced to a country that does not have a minimum tax rate of 15%, other countries are allowed to charge a top-up tax, such that the multinational is paying a 15% tax rate in each country in which net income is sourced. In short, countries that adopt a plan would charge additional taxes, a top-up tax, on the net income of a multinational that is sourced to countries that have not adopted the minimum tax. This top-up tax concept creates an incentive for noncompliant countries to comply so that they can claim the tax revenue that otherwise would be claimed by other countries. By at least one estimate, the global minimum tax proposal, if enacted, would generate about $150 billion in additional tax revenue across the globe.

So where are we in terms of implementation? Well, it hasn't been implemented, but last December, a 70-page model rules document was released and then in March of this year, just a few months ago, a 228-page commentary on the model rules was released. By rough analogy, you can think of the model rules that were released last December as equivalent of a statute and you can think of the commentary that was released in March of this year as the somewhat equivalent of regulations. And as of today, we next expect additional implementation guidance to be set forth by the OECD and the European Union is considering approving the package. The goal is to have the rules take effect in 2023, though, that date appears to be slipping. I should also note, in addition to the European Union considering approving the package, maybe by the end of this month, more likely in the coming months, the U.S. is also firmly behind adoption of these rules.

Now, with that as background, let's turn to how a global minimum tax rate of 15% could affect investment in community development tax credit equity. As noted, the goal of this international effort is to ensure that corporations pay at least a 15% tax on book income. So the simple question is how do U.S. community development tax credits affect the calculation or the determination of this 15% tax rate? The corollary or derivative questions are, is the minimum rate calculation determined after a company reduces their taxes by U.S. community development tax credits or before? And another question: is the calculation determined by excluding investments in community development tax credits? These are some of the questions that companies face. In discussing community development tax credits, we’re principally referring to the low-income housing tax credit, new markets tax credit, historic tax credit and renewable energy tax credits and also any future credits that might be enacted, like the neighborhood homes investment credit. I further note that low-income housing tax credits and renewable energy tax credits are getting the most attention right now, as those credits have the greatest potential to move the effective tax rate needle, given the volume of annual tax credits in those areas. New markets tax credits and historic tax credits are affected, but they're less likely to move that 15% needle, if you will.

Now, it may be obvious to many, but it is worth emphasizing that this issue arises because the largest investors by dollar volume in U.S. community development tax incentives are multinational corporations, which fall under the umbrella of the global minimum tax rules. For those corporations that are under the umbrella of the global minimum tax proposal, an investment in tax credits could reduce their effective tax burden to less than 15% and unless there is some mitigation, those corporations have to pay additional taxes in other countries and those additional taxes could reduce the benefit of their tax credit investments, which of course would lead many current investors to invest less and to potentially sell existing investments.

This issue is one that we at Novogradac have been tracking for a while. When we reached out to the Biden administration last year to inquire as to whether U.S. community development tax credits would offset the proposed domestic minimum tax as well as this proposal global minimum tax, we did consistently get a positive yes on the domestic front and a nerve-wracking, if you will, or a concerning silence on the global minimum tax. The somewhat positive news now is that many stakeholders have been tracking the issue and efforts to address the issue have ramped up after the rules document was released last December, along with the equivalent of the regulations that were released in March. Many participants have been working with the U.S. Department of the Treasury to try to find a way to retain the value of tax credits for international investors. Novogradac is among those organizations working to find ways to mitigate the adverse effects and my partner, Brad Elphick, who is with us on the podcast today, is the leading Novogradac's efforts on that front.

As I said earlier, Brad works out of our Atlanta office. If you've attended on of our new markets tax credit conferences, if you were there at the conference we just had in D.C. last week, you've probably met Brad. But he also works in other areas, including affordable housing. He's been a guest on Tax Credit Tuesday several times, most recently in January of this year when we talked about generally accepted accounting principles concerning tax credit equity investments. Brad is also the principal author of a white paper that Novogradac has published on the matter of the global minimum tax and tax credit equity investments. Today, Brad will join me to unpack the global minimum tax proposal and its possible effect of tax credit equity investing. We'll look at the potential problems and some potential mitigations for the tax credit equity investment issue. We'll also examine the next steps for this proposal and what listeners can do. There's a lot to talk about, and this is a complicated, important issue. So if you're ready, let's get started.

So Brad, welcome back to Tax Credit Tuesday.

[00:08:36] **Brad Elphick, CPA:** Thanks, Mike, glad to be back.

[00:08:39] **Michael Novogradac, CPA:** So in the opening, I gave a somewhat lengthy overview of the global minimum tax proposal and the potential issues for various community development incentives. If the global minimum tax proposals are adopted, tax credit investments could be deeply affected by this proposal to the negative. But as with many things, there's lots of details to work through at a better gauge the real effect. Now I did describe the issue in my introductory comments and before we move to possible approaches to mitigate the adverse consequences, I wanted to see if there's anything more that you wanted to add to my introduction to amplify or further clarify some of the challenges.

[00:09:19] **Brad Elphick, CPA:** First it was a very good overview, extremely detailed. A couple of things I would add to it is just reemphasizing the importance of the issue and as you mentioned on the tax equity markets. When most people listening to this podcast think about what impacts typically in terms of price and I think that's ultimately what the largest concern here is the impact on the value of these tax credit investments that were created to incentivize investments in different types of communities. Ultimately, the concern is that if they have this reduction in the value of this tax credits, we may not see the level of investments in low-income communities and renewable energy and for other purposes as we've seen in the past. Ultimately, it's important to recognize that this could impact all of the different types of tax credit investments and so if people are wondering, why do I care? I think there's a lot to care about here and I think it's helpful that more that people understand this because it is ever evolving. Ultimately, one of the scary aspects of it–and we'll talk a little bit about it from a policy perspective–is that there's an incentive built into these model rules as you described them for companies or countries to adopt the model or the global minimum tax. And so it doesn't really matter if the U.S. adopts the global minimum tax, it will still have an impact on these multinational corporations, which is why we continue to follow this, regardless of what we may hear from time to time in terms of its likely, adoption by the U.S.

Timing on Equity Investments

[00:10:59] **Michael Novogradac, CPA:** That's a great point about the U.S. not having to adopt compliant rules in order for U.S. tax credits equity investments to be affected. Also some will suggest that it’s not supposed to take effect until 2023 or later, so it really do we really need to focus on it now? Maybe you could comment on the impact these rules could have in the equity investment market and the timing as to when the equity investment market might respond to the potential risks here.

[00:11:23] **Brad Elphick, CPA:** Yeah, that's the big question I have. And my concern is that we are getting a lot closer to when it may start to have an impact on pricing. As we've seen in other downturns, downturns of the current economic environment and such, pricing tends to get out in front of those changes or out in front of something becoming officially adopted or officially implemented. So my concern ultimately is with uncertainty or certainty that it is negative, either of those, I think can have a downward pressure, as investors are going to be required to look internally just to plan for this. And as we know that these different tax credit investments, there's a long horizon and we're not just looking at the next six months, it's typically tax planning for a much longer period of time. I think that's my concern is related to that uncertainty and its ultimate impact. So with the implementation potentially being in 2023, maybe we can talk about that later of whether or not I actually think that's when it will happen, but as we've seen with any kind of tax changes, even domestically here in the U.S., the closer you get to the end of the tax year or even after the tax year, it becomes a lot harder to prepare for. And so there would be a significant burden, I think, as the longer that this goes and gets closer to this potential implementation here.

[00:12:52] **Michael Novogradac, CPA:** And I think it in many ways is similar to the issue we faced when Donald Trump was elected president and there was an anticipation of a lower corporate tax rate. The equity markets pretty quickly adjusted. Those credits, like the low-income housing tax credit that was heavily driven by the or influenced by the value of tax losses, the anticipation of a lower corporate tax rate caused investors to hedge in terms of the pricing because they didn't know what the benefit of those tax losses would be. So here, similarly, if there's a potential mitigation that companies feel they can rely on in the equity market, it's going to end up not being adversely, too dramatically adversely affected. But if there isn't a belief among corporations if there are mitigations, then you'll start seeing equity price effects well before anything is enacted. There will be more, like you say, these credits are multi-year investments for the most part and as a consequence, companies have to make multi-year estimates, so it's definitely something that we have to be out in front of, which is one of the reasons why I know that you helped draft the memo on some of these issues.

But let's now talk about some of these mitigations. There have been several possible approaches to potentially mitigate the adverse effects of a proposal of a minimum tax on U.S. tax equity investments, so if you could maybe briefly run through the handful of approaches that have been discussed in some detail publicly by different parties, including us. Then after you run through briefly a few of the approaches, we can dig into each one a little bit more detail.

Potential Mitigating Approaches

[00:14:30] **Brad Elphick, CPA:** Sure. I think there's really three main approaches that have been explored and I put those three approaches in kind of two different buckets. One is what can Congress do and then what can the OECD do, the governing body of these models?

And so the first approach that we've discussed or have heard discussions about is the notion of refundable tax credits and whether or not in terms of those being excluded from these calculations. And we'll get into more about what refundability means, but typically our U.S. tax credits are not refundable, especially the ones that we're talking about. And so there's some concerns there about refundability. The next one is when you look at our general business credits and tax credits that we're accustomed to, a lot of times they're referred to as transferable or investible tax credits and one of the approaches is well, can we get that included or can the OECD clarify that those can be included as refundable tax credits and be treated on the same level as refundable tax credits? Now that would be one that would require most likely a change by the OECD, possibly a rule change, which would, I believe, be much harder at this point, or potentially in the form of guidance, but it's unclear at this point as to exactly how that could occur.

But then there's the third one that has probably gotten the most attention, which is an approach that looks into the rules that have been drafted and finds a way to mitigate them. This is what we commonly refer to as the equity investment exclusion approach. That would be one where, in order for these multinational corporations, these investors, to get comfortable with, would need additional guidance from the OECD.

[00:16:27] **Michael Novogradac, CPA:** Brad, thank you for outlining the three broad categories: refundability, transferability as the equivalent refundability and the equity investment exclusion approach. Now let's dig into each one in a little bit more detail and let's start with the refundability option. Under this option, tax credits have to be refundable within four years and if they're refundable within four years in substance, not just in theory, then they get a more beneficial treatment in terms of the tax rate calculation. Now, as you noted in order for that to happen, legislation has to be passed in the U.S. to make these various tax credits refundable and obviously the president would then have to sign that legislation. So if you could share with the listeners how practical that option is both from a political perspective, a policy perspective and a budgetary perspective.

[00:17:28] **Brad Elphick, CPA:** I think I can say pretty confidently in terms of all three of those, it's probably the least likely. As you've alluded to, changing the current tax credits as we have them, to become refundable would be a major sea change. And trying to get Republicans and Democrats to agree on that in the current political environment–and we don't really have to get into what the current political environment is, but it's not one necessarily of a lot of bipartisan efforts. So in order to get a legislative fix of that in the future, I think from a political perspective would be very difficult. I think that if there's a lot arguments for why it would not be a favorite from a policy perspective either. There have been many discussions over the years about why the current form of tax credits is a better model than having refundable tax credits, so I think that from a policy perspective, when you talk about abuse, potential abuses and government's ability to essentially reclaim any funds that were provided through that kind of structure, I think would be a hard sell. And then if you did have refundability, refundable tax credits, that would be an immediate, additional cost to the federal government, which would I think be not insignificant and, you know, the question is the money really, even there to change these tax credits to become more refundable. So, you know, when you asked from a political policy and cost approach, if I'm putting them on a spectrum, I'm putting them on the end of least likely to occur.

[00:19:10] **Michael Novogradac, CPA:** I certainly agree with that, as our listeners probably could tell the way I framed the question. I will also note that initially Treasury and the White House's response was to go down the refundability approach and for the reasons that you outlined and I outlined in my question, it wasn't a very pragmatic answer. I will note in terms of the policy behind refundability, there's definitely a large support for creating a refundability aspect for say renewable energy tax credits, and you know, we at Novogradac are supportive of those efforts, but when we talk about the policy benefits of refundability or lack of refundability across all tax credits, that's a more challenging question and certainly one that ought to be–the refundability question ought to be driven by policy reasons and not to be driven by the fact that there's some international general business or minimum global minimum tax or some cost considerations. It ought to be policy-wise, is this the preferred option? And that should be what leads the debate, not some of these other issues, but let's go ahead.

[00:20:16] **Brad Elphick, CPA:** I would just add one thing too, about the kind of political landscape and your note about that as an initial reaction was, well, let's just make them refundable since that is included in the model of rules. And I think that just highlights the level of concern that we've had for a while and the concern of how much attention has been paid to how these model rules may impact tax credits and tax equity investments. The fact that that was the first response, I think, or one of the initial responses that just shows, in my mind, some parties being late to the analysis here and again is probably why I think that from a political perspective, it's the least likely outcome.

[00:21:04] **Michael Novogradac, CPA:** And the good news is the Treasury Department now has leaned in pretty aggressively on other approaches and we're thankful for the approach that the Treasury Department is taking at this time.

So let's talk about transferability because we've talked about obviously the refundability and there is also the notion of saying, well, if refundable tax credits are treated differently and not as adversely affected as general business tax credits might be, subject to these other approaches, the fact that you have investible credits–they're not technically transferable, but they're investible–all where a party is entitled to the credits and they're able to bring in investors that in essence, give them equity, for the benefit of those tax credits as well as other tax incentives, along with an economic interest beyond the tax benefits. But that's pretty close to being refundable in the sense that they're investible and they're not technically transferable, but the economic benefits are from the standpoint of the project that needs the capital, they're getting the economic value from those incentives in terms of cash. So how practical is this notion of saying, well, we're going to get the transferability aspects of these through investability treated as equivalent to refundable.

[00:22:25] **Brad Elphick, CPA:** I would say that it is a little more likely than having Congress change the current tax credits to become refundable. However, I think when you look at these model rules that have already been published, the iron has been struck in terms of the framework. I think that there are a lot of positions that, well, if you wanted transferrable or investible credits counted the same as refundable credits, the U.S. should have negotiated them before the model rules came out, there was an opportunity. And with the notion that you have a lot of other countries that have essentially signed on to this notion of refundable credits being excluded and it may not have ever been the intention for it to include the types of tax credits that we're describing, I think it becomes a lot harder sell to get them included at this juncture. I'm not saying it's impossible, but it's a little bit harder.

[00:23:27] **Michael Novogradac, CPA:** So it's still a heavy left, but not as heavy a lift as the U.S. Congress making credits refundable. And I did want to also say for the benefit of our listeners–I should have said this at the opening–a lot of the ways you and I are describing matters from a purely technical perspective could be subject to critique, but we're grossly simplifying a lot of these issues. As a consequence, some of our language out of context could be, you could look at and say, well, that's not quite right. And we recognize that, it's just a difficult topic to address in a short forum like this. And one example of that, that Brad's aware as Brad just mentioned, that you would exclude qualified, refundable credits. You don't technically exclude them when you walk through the calculations as Brad knows, but it gets a more favorable treatment that sometimes you might colloquially think of it as being excluded or not as being adversely affected because of the way in which they're treated. So just know as a listener to this podcast that we're taking a lot of colloquial shortcuts and that's something that is inherent in a normal conversation versus a written conversation. And when you read our paper, you'll see a lot more of the more specific non-colloquial discussion.

Equity Investment Exclusion Approach

So let's turn now to the sort of third option or approach that's currently getting the most attention. And I certainly don't want to say these are the only three approaches that we're covering here today and there's a lot of wood still to chop here and we don't know how these various interpretations will go. And I also don't want to suggest that the interpretations that we're discussing here are the only ways to interpret the rules. These are reasoned interpretations. They're not the only possible interpretation. And that's one of the reasons why we have a whole discussion that we're going to go into in a bit about what more we need from the OECD to build out and reinforce these interpretations or let us know that these interpretations aren't accurate so we can act accordingly. Because what's most important is that we know how every country is going to treat these investments, so we know what the impact will be for investors and that might help inform to what degree of the U.S. supports these rules as they're being expressed. So all of that as a precursor to the central topic, really, of the podcast and of the working paper that you led took the lead in drafting, Brad, is what's referred to as the equity investment exclusion option. I'll say that again, equity investment exclusion option or approach.

So Brad, if you could explain that option or approach or interpretation because really not an option in the sense that you get once again, in the sense that you get to elect, it's more an interpretation of the existing rules and how that interpretation of the existing rules could help mitigate concerns around the 15% global minimum tax.

[00:26:30] **Brad Elphick, CPA:** Of course, and I think that's exactly right. It's an interpretation that we hope at some point is affirmed in writing. But the reason why we got to this approach is because of what we just discussed about the other two approaches and how likely they may or may not be. And so when you take a dive into the model rules and the commentary, we start looking at what framework is there that we could work with to ensure that there's favorable treatment for our equity tax credit investments.

And so first just starting at the base, the foundation, I guess, for determining the effective tax rate is to look at entities' book income on a consolidated basis. And so, as entities are preparing their financial statements under a GAAP or IFRS or other acceptable methods, they would be looking at that from a consolidated entity and so when we look at investments accounted under the equity method, they wouldn't be consolidated as we've discussed. And so when we look at the rules and the model rules and then the commentary associated with them, there is specifically exclusions of certain types of gain or loss including excluded equity gain or loss as a defined term. And this defined term, excluded equity gain or loss, is defined as profit or loss in respect of an ownership and interest included under the equity method of accounting. So that's how we get to the starting point of this equity method exclusion.

[00:28:13] **Michael Novogradac, CPA:** Just to clarify that, entities determine their 15% effective tax rate on a consolidated basis and as part of the adjustments to determine their effective tax credit consolidated investment basis, they exclude entities accounted for under the equity method because those entities are not consolidated, they're under the equity method. So maybe now you can talk about, OK, if you exclude those entities under the equity method, then presumably would you eliminate both the income and loss effects as well as the tax effects. And maybe you can build off of that.

[00:28:47] **Brad Elphick, CPA:** Right. That's part of the interpretation. That this exclusion would include the tax effects of those income and loss items. And so ultimately, as we noted in the paper, that the 15% rate would be determined before any reduction for tax credits and other tax benefits and this would protect the value of those equity investments and the tax credits. It would not have a change in the value of those tax credits even if a corporation using the equity method exclusion approach and has a tax rate below 15% would have to pay a top-up tax. There would not be a detriment to continuing to invest in tax credits because they're not ultimately the main types of investments that are reducing the overall effective tax rate. So when we look at investments in general, business tax credits, notably the ones that you described, LIHTC, renewables, historic, new markets, those are typically structured using pass-through entities such as partnerships and LLCs, and as preparers of those financial statements, they're required to evaluate whether it should be consolidated. And since these investments are typically not consolidated and are accounted for under the equity method of accounting, we get to the kind of the conclusion of our interpretation is that those equity investments would be excluded and not cause a reduction in the effective tax rate and so that's, and very briefly, as you mentioned, we go into more details in our paper that we've put together, but ultimately that's an overview of the equity method exclusion.

[00:30:34] **Michael Novogradac, CPA:** That's good. I mean, I just think of it more simply as you basically would look at those consolidated financials as they are now and you would pull out all your tax credit equity investments under this exclusion approach. As a consequence, any income or loss flowing through those equity investments would be pulled out and any tax credits or tax costs associated with those investments get pulled out as well. That's simple and it's almost like a sidecar calculation. And the beauty of that is even if what remains is still below a 15% rate such that the top-up tax is due, the economic benefit to the company of investing the tax credits is preserved. So that's one of the attractions of this approach, which as you noted is a reasonable interpretation of the rules as they stand today.

Now, there are some questions I'm sure our listeners have now when they hear about this equity method of accounting and they'll say, OK, I understand the equity method of accounting, understand that under the model rules they generally speaking get excluded. But for low-income housing tax credits, they're often accounted under this proportional amortization rule and we don't need to go through the details of how that rule works. We're going to assume the listeners know what it is. Then there's also with renewable energy credits, there's this hypothetical liquidation of book value or HLBV rules. And the questions I know that we've gotten is to what extent is proportional amortization or implementing HLBV rules, to what extent are those treated as equity method of accounting, such that they would qualify under this equity method of accounting exclusion?

How Proportional Amortization, HLBV Are Viewed Under Equity Investment Exclusion Approach

[00:32:14] **Brad Elphick, CPA:** Sure. And I think the important thing here just to note is that both the proportional amortization method and HLBV are all codified subsets of the equity method under U.S. GAAP. And so when you go in to look at the codification of equity method, you can dive into to it and find proportional amortization in HLBV and so, as you mentioned, it's still a question of, OK, that's great. The concern is that what everyone who created the model rules and understood and intended and that's ultimately why, in addition to guidance about the equity method exclusion and getting our interpretation affirmed, it would be the best case, is also to affirm that equity method as understood under U.S. GAAP includes proportional amortization in HLBV. And so we think that there's because of them being subsets, that should be the reasoned interpretation.

Joint Venture Rule

[00:33:18] **Michael Novogradac, CPA:** So thank you for that. And once again, I would direct our listeners to the memo that we have or the paper that we have on our website dealing with these issues. Because there has been a lot of positive commentary coming from the OECD and Treasury officials and the like with respect to these interpretations, so it does appear that many agree with this analysis. But one question that has come up, that you and I have discussed quite a bit, Brad, is what's called the joint ventures rule. The equity method exclusion approach basically takes away the equity method or the investments accounted from the equity method out of this determination of a 15% minimum tax rate. But then there's this joint venture rule that has some potential separate application to investments accounted for under the equity method. So maybe you could explain when the joint venture rule kicks in, what types of entities are subject to it, what it's intended to do and how that might apply to tax credit investing in the U.S.

[00:34:32] **Brad Elphick, CPA:** It is important to start with what is a joint venture and a joint venture is one in which an entity has 50% or greater ownership interest and rights. And the concern was, and I think the intention for the joint venture rule was, to prevent companies from shielding income from this global minimum tax by forming entities in low-tax jurisdictions and then excluding the income from such entities under the equity method. And so when we look at that as a preventative measure, focused on companies moving their income to low-tax jurisdictions, well, we have to also look at if we have companies that are making these investments, typically at 99% or some very high percentage over 50%, would those be considered joint ventures and preclude those entities from using this equity method approach that we described?

[00:35:32] **Michael Novogradac, CPA:** Well not really preclude, they would cause the joint venture itself to be subject to the rules and they could end up so that it's not so much exclude or not excluded, it's more that there's a whole set of ways in which the global rules apply to joint ventures that cause the investor in the joint venture under the equity method to pay, to be subject to a higher a top-up tax.

But I think the key as you, as I know, you were about to say, is that the U.S. isn't considered a low-tax jurisdiction. So the joint ventures need to be operating in a low-tax jurisdiction. Even if they are joint ventures, that the general view is that since the U.S. wouldn't be considered a low-tax jurisdiction, the rules wouldn't have adverse effects and there's other analysis as well, with respect to joint venture rules. But I feel like those are probably the two keys that lead us to get past the joint venture rules and if those analysis isn't enough, there's additional backup analysis or other potential ways in which you would view this to not have an adverse effect. Is there anything to joint venture rules or should we move on?

[00:36:46] **Brad Elphick, CPA:** I think you're exactly right. I was getting to the point that after at the end of the day where the U.S. is not a low-tax jurisdiction and that's probably the most important part when we were looking at these joint ventures.

Portfolio Shareholdings

[00:37:01] **Michael Novogradac, CPA:** So the other issue that's come up is the portfolio shareholdings. And maybe you could describe what a portfolio shareholding is and what the concern has been and then the fact that this issue probably doesn't have too dramatic an impact, irrespective of the answer.

[00:37:20] **Brad Elphick, CPA:** Sure. A portfolio shareholding is an ownership interest in an entity that carries rights to less than 10% of the profits, capital reserves or voting rights. And when simplified, I think the overall rules were intended to include anything consolidated except and exclude everything else. Like investments counted under the equity method except for when there are joint ventures as we discussed before and portfolio shareholdings. And so because of this kind of concern, similar to joint venture rule, is a notion of, well, does this somehow capture any of the types of investments that are made for tax credits? And we don't really believe that it has a large impact because if you're less than 10%, have an ownership of less than 10%, we're probably not talking about that much of the volume of transactions that are done and also the impact on the calculations that an entity would have from an investment in which they held something less than 10%. So ultimately, I think there is a question about portfolio shareholdings and the ability, if you do fall under this portfolio shareholding provision, of whether of how the equity method explosion would be applied.

[00:38:51] **Michael Novogradac, CPA:** And then as you've mentioned, the key point here is that the portfolio shareholding rule kicks in when you have less than 10% of the profits, capital reserves or voting rights in a given equity investment or in a given investment, I should say that may or may not be accounted for under the equity method of accounting. We don't think it should be that significant to investors, because if you're investing at that level, it's probably not having that dramatic an impact on your effective tax rate anyway. As you noted, it's unclear to what extent, if you're accounting for under the equity method exclusion rule applies, at an initial reading, the answer is yes, whether or not a final reading yields that same answer is TBD.

So let's turn now, if I'm an investor or project sponsor and I'm concerned about how the global minimum tax might affect my ability to invest or my ability to raise tax credit equity. Maybe describe some of the next steps and I ask it in a way that says, you know, *if* I'm concerned, but I think every investor or project sponsor should be concerned, so they should be asking what are the next steps here in terms of getting mitigations to the potential adverse effects so equity investing isn't notably affected.

Next Steps

[00:40:08] **Brad Elphick, CPA:** Sure. And I think that if we believe that changing our tax credits to refundable tax credits or having transferable credits be the equivalent of refundable tax credits is less likely, that ultimately the next steps would be to get some kind of implementation guidance from the OECD that gives clear confirmation of these different interpretations that we've talked about. Because I think without any–and not only just clear guidance, but also that the other countries that will be adopting these model rules will interpret these approaches the same way. And if they don't agree with that, that it would be better for companies to know that now. I think that overall, obviously we would want the guidance to come out to affirm this, but one way or the other, I think it's important for us involved in raising tax credit equity and/or investing, that this guidance is known and understood. It's unclear, as you can imagine, with 130-some plus countries, there's lots of different opinions on some of these issues and when we get into the notion of how this may impact U.S. tax credits, other countries may not have had the same understanding or interpretation that we have come up with. So, the importance of countries ultimately getting on board and adopting that same interpretation is an important next step. If there is a favorable guidance, I think that will have a very positive impact in terms of the concern that investors have had on the global minimum tax and its impact on tax equity investments. So I think in our memo that we've put together, we focus a lot on that guidance that is needed, because I think that a path forward to preserving the value of these tax credit investments.

[00:42:20] **Michael Novogradac, CPA:** So I would encourage our listeners to download the working paper and we'll link to in our show notes. But if you also just Google Novogradac global minimum tax equity investments or something like that, it'll take you there. I'd encourage you to download the paper and share it with investors that you work with, syndicators that you work with that are raising money from investors that are likely to be subject to these rules if they are enacted and also share it with your members of Congress and Treasury and express your concerns. I also think, as I know that you do that, it's critical that we get very clear guidance from the OECD as to the application of this equity method exclusion analysis to U.S. community development tax credit investments. It's very important that there be clear guidance here so when this gets administered, if it does get enacted, across a sufficient number of countries, that individual countries don't start interpreting it differently. We run the risk that we get unclear guidance from the OECD and individual countries start treating this differently and then we get a few years down the road and suddenly, companies are losing some value or tax credits and it's too late for us to adopt a different rule or a different approach. So it's very important that we get this very clear understanding and one of the ways to do that is through circulating our sort of working paper so that the issues are clearly stated, the analysis is clearly stated and others can either agree and say we think this is the correct interpretation or disagree and say we don't think that this is the correct interpretation, we think this or this should be changed. So at least we're all aware of that.

[00:44:13] **Brad Elphick, CPA:** Yeah. And I think that the socialization efforts that have been taking place have borne some fruit already. When you look at the public comments that Treasury is making now versus before, there definitely appears to be a greater understanding and appreciation for the need to get that type of guidance. Then there's also been some good public comments made by the secretary of the OECD about some of the questions, which is all great, but it also needs to end up, as you said, in clear, concise guidance that leaves little room for interpretation by all of the other countries.

[00:44:53] **Michael Novogradac, CPA:** An example would be particularly attractive. So thank you for participating here today, Brad. This is probably a little bit longer podcast than we typically do, but this is an issue of such wide application and such potentially damaging effects that it's really worthy of the time that you've given it and our listeners have, those that have stayed with us for a full podcast. Before we wrap things up, I just wanted to see if there's anything else that you think you wanted to share with the listeners.

[00:45:22] **Brad Elphick, CPA:** No, I think that's it. It's an important issue. It's an ongoing issue. It's an evolving issue. Who knows? We may be getting on another podcast in a couple months to give more updates on this issue. But no, I think we've covered a lot here today in a short period of time.

[00:45:40] **Michael Novogradac, CPA:** Great. Thank you, Brad. And please do stick around Brad for our Off-Mike segment of the podcast, where I get to ask you some fun questions that aren't directly related to tax incentives and I'll provide Brad's email address in the show notes. We'll also provide a link to that document and I encourage you to reach out to Brad. If you're not already a member of our New Market Tax Credit Working Group, our GAAP Working Group or a number of other working groups that encourage you to join one of or more of our working groups as well. We're able to use some of the revenue from our working groups to help fund efforts like this one here, so any support you can provide, one of the working groups we'd appreciate it.

To our listeners, please be sure to tune into next week's episode of Tax Credit Tuesday. My partner Frank Buss from Dover, Ohio, will be here to discuss the Financial Accounting Standard Board’s new lease standards that were implemented January 1 of this year. These new lease standards can have major effect on any business with an operating lease and we'll break down the consequences for different tax incentives, such as renewable energy, the new market tax credit, historic tax credits and low-income housing tax credits. So it's a podcast or want to make sure that you listen into and obviously make sure that your CFO and controller are listening into as well.

You can make sure that you're notified of that episode and each week's episode, by following or subscribing to the Tax Credit Tuesday podcast. Go to www.novoco.com/podcast to subscribe to and stream the show on our website. You can also follow or subscribe to Tax Credit Tuesday on iTunes, Spotify, Google Podcast, Stitcher, and Radio Public.

Off-Mike Section

Now I'm pleased to reach our Off-Mike section, where listeners can get some off-topic advice and words of wisdom from our podcast guests. So Brad, I'll start with this podcast being a great example of the need to stay aware of changes in your field. So I thought I'd ask you, beyond the Tax Credit Tuesday podcast, how do you keep updated on what's happening and what’s changing in areas that you work?

[00:47:41] **Brad Elphick, CPA:** Well, you took the words right out of my mouth, I said Tax Credit Tuesdays. But I'm fortunate to be in a field, in a business that focuses on the ever-changing landscape. And I think that I get a lot of my information obviously from what our efforts are in the policy space and in the technical tax and audit space. But I am online a lot on various news sources and just trying to absorb as much as I can. I never feel like I'm all the way there and that's the great thing about what we do is that you never get all the way there and just as soon as you think you are there, it changes. That's what the topic of today's podcast was about is something that could possibly change and negatively impact. And so what I have seen is the importance of staying on top of it because it's very easy to get left behind or it's very easy to not realize how something may impact and be able to plan accordingly for it. So, I don't know that I have necessarily one source to keep updated. And I think that there's a lot of good information out there and lots of various opinions on information that I try to draw from.

[00:49:02] **Michael Novogradac, CPA:** No, that's all I have very good. I also use Twitter and I have a very limited number of feeds that I follow. So I find Twitter can be a way of getting some pretty targeted information areas of your practice, if you curate well, who you follow very well. If you don’t, it's not quite as useful. So concerning your job, what do you know now that you didn't know 10 years ago, but wish you knew 10 years ago?

[00:49:33] **Brad Elphick, CPA:** You know, I think that's a hard one. I think I might've said something to this effect on one of our other Off-Mike sections. I think every year I get a greater and greater appreciation for relationships, especially professionally. It's very easy to say that accountants aren't the most extroverted people and have a hard time talking to people, but I think it's definitely an important part of what we do and being able to convey difficult topics, but also to develop working relationships. I think that when trying to grow my business and my expertise, I tend to get those from those who I have closer relationships with. And so that's why you do see me at a lot of conferences and visiting lots of clients because I am trying to cultivate and maintain relationships, but obviously it's a very important task to pick in your personal life too. And, I think finding a balance so that you don't sacrifice personal relationships because of your professional desires or vice versa, I think is something that I probably didn't have a great appreciation for 10 years ago or 20 years ago when I've been going down this path.

[00:50:41] **Michael Novogradac, CPA:** Well, certainly COVID and the lockdown enhanced one's appreciation for the value of personal non-Zoom relationships.

[00:50:50] **Brad Elphick, CPA:** I miss everybody in person. It was good at seeing so many people this last week in D.C. for our new markets conference.

[00:51:00] **Michael Novogradac, CPA:** Yes, it was. So the third and sort of final question I wanted to ask you is, now that we're nearing the midpoint of the year, in terms of like goal setting, a lot of people set up calendar-year goals so that would mean you were getting towards the middle of the year, and it's time to be revisiting them. So how do you yourself track goals and when do you revisit them and make adjustments? Tell me a bit about how goals play in your life beyond lacrosse goals.

[00:51:31] **Brad Elphick, CPA:** As a partner in accounting firm, we have lots of good spreadsheets to help keep and review goals, so there's those obvious places too, but I don't necessarily focus on, OK, it's New Year's resolutions and things like that. I try to keep them a little more broad, but I try to write them down, both my personal ones and my professional ones and revisit those on a periodic basis. But I try not to get wrapped up into, OK, yes, I met it or no, I didn't meet it. I try to look at the efforts that were made and understand whether or not those efforts were focused in the right areas to meet some of my goals. And what I find is that sometimes I feel like I'm really focused, but it's in the wrong direction and revisiting those goals helps me refocus some of my energies but know that's the way I try to look at it. I'm not a list person per se. I learned a long time ago, I will never meet my goal for how many books I want to read this year. So I look at it more just from a standpoint of my efforts and my energy and where it's focused.

[00:52:41] **Michael Novogradac, CPA:** I really liked the focus on effort as opposed to outcome, because there's so much chance in the actual outcome and effort plays such a greater role and effort gives you more chances for positive outcomes, but that ensure outcomes and sometimes you can have positive outcomes purely by chance. So you don't control chance. You can control effort to put yourself in more opportunities to be lucky. But I really liked that on effort. And I know as a parent, we always, Barbara and I always focused on encouraging our children to put forth the effort and try to be more models and encouragers of effort as opposed to outcome. Because the effort was within their control, the outcome wasn't always within their control. So that definitely was a parenting strategy as opposed to my own goal-setting strategy. So we're on the same page there.

[00:53:44] **Brad Elphick, CPA:** Definitely. And I think that's a great point about our children. One of the things when both of my kids were essentially born, at that point in time, one of the things I always wanted to try to pass along to them is work ethic and effort. And it, you know, at the end of the day, as long as you're giving everything that you have, I think as you said, the outcome becomes a little less important.

[00:54:08] **Michael Novogradac, CPA:** So thank you again, Brad. And to our listeners, Mike Novogradac. Thanks for listening.

Additional Resources

Email

Email Brad Elphick

Novogradac Memo on Global Minimum Tax

Pillar Two and Tax Credit Equity Investments