National Council of State Housing Financing Agencies

Analyzing the Impact of Tax Reform

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1. **Income Averaging** – Tax Reform now allows projects to include some 70% and 80% AMI units as long as the average income limitation does not exceed 60%. This topic will be covered extensively in other sessions during the conference.

2. **Tax Rate Change**
   a. 35% corporate rate → 21% corporate rate – Tax reform lowered the corporate tax rate from 35% to 21%. LIHTC equity pricing reflect the benefits of both tax credits and tax savings from deductible losses. Because $100 of deduction now saves $21 rather than $35, the value of the deductible losses dropped significantly. As a result, equity pricing is lower now than it would have been under the old 35% tax rate.
   b. Market Anticipated Some of the Rate Change – Due to anticipation of tax rate change after the Presidential election, must of the impact in pricing had already been reflected in equity pricing in 2017. However, many investors had been predicting a 25% tax rate and thus the 21% rate caused pricing losses to be worth less than anticipated and caused a somewhat larger decline in pricing.
   c. State Credit Impact – Has the reduction in the corporate tax rate led to an increase in the average investment per state tax credit on allocated transactions? What about on certificated transactions? Now that individuals are subject to a %10,000 cap on state and local tax deductions, do we expect to see a broadened market for state tax credits?

3. **30% Limitations on Interest and "Electing Real Property Trade or Business"**
   a. New 30% Interest Limitation – Pursuant to Section 163(j)(1) of the Code, the amount allowed as a deduction for business interest for tax years beginning after December 31, 2017 is limited to 30% of the "adjusted taxable income" of a taxpayer for the taxable year. The amount of any interest deduction disallowed for a taxable year can be carried forward to succeeding taxable years. For partnerships, adjusted taxable income is calculated at the partnership level. Pursuant to Section 163(j)(8) of the Code, a partnership's "adjusted taxable income" means the taxable income (or loss) of the entity computed without regard to (i) business interest deductions and (ii) for years beginning before January 1, 2022, deductions allowed for depreciation and amortization.
   b. New Rules Don't Apply to an Electing Real Property Trade or Business – An "electing real property trade or business" may irrevocably elect to be exempt from the foregoing interest deduction limitation rules but must accept slow ADS depreciation on the building.
      i. What qualifies as an electing real property or business?
      ii. What is the effect on depreciation of a business's assets if the business makes the election to be treated as an electing real property trade or business?
      iii. When can a business elect to be treated as an electing real property trade or business, and what does it mean for such election to be "irrevocable"?
      iv. If a business does not make the election and instead accepts the 30% interest limitation, are partners' capital accounts only impacted to the extent of the

30% interest deduction? (Code §469(c)(7)(C); Code §163(j); Notice 2018-28)

4. **Building Depreciation**
   a. 40 Years → 30 Years – Normal depreciation for LIHTC buildings is 27.5 years straight line. However, buildings sometimes choose to take (or are required to take) depreciation under the longer alternative depreciation system ("ADS"). Prior to tax reform this was a 40-year straight line. Tax reform now says the ADS life for residential rental buildings is 30 years instead of 40 years. (Code Section 168)
   b. Impact on Capital Accounts - If an Investor runs out of capital before all of the LIHTC is delivered and there is not any "minimum gain", this can lead to LIHTC being allocated to other partners. The inability to use 40-year depreciation makes solving such a capital account problem harder.
   c. Structuring Highly Leveraged Transactions – In light of the change of ADS from 40 years to 30 years for residential rental property, how are highly leveraged transactions (e.g. tax-exempt bond financed transactions) being structured? Are special allocations of non-depreciation items to the general partner a feasible fix, and if yes, what are the pitfalls? Are we OK with specially allocating interest related to seller financing? Are there any concerns with specially allocating non-depreciation losses to a tax-exempt entity? (Treas. Reg. §1.704-1(b)(2)(iii)).
   d. Impact on Pre-2018 Buildings – Does a pre-2018 building use 30- or 40- year depreciation if the owner elects to be an Electing Real Property Trade or Business?

5. **Bonus Depreciation**. Prior law provided for 50% bonus depreciation for personal property and site improvements, which was scheduled to start phasing down in 2018. Tax Reform generally increased such bonus depreciation to 100% of the adjusted basis of such property if it is placed in service in after September 27, 2017 and prior to January 1, 2023, (c) 80% of such property if it is placed in service in 2023, (d) 60% of such property if it is placed in service in 2024, (e) 40% of such property if it is placed in service in 2025, and (f) 20% of such property if it is placed in service in 2026. (Code § 168(k))
   a. How is this change in the bonus depreciation rule impacting LIHTC transactions?
   b. Does bonus depreciation apply to used property? What are the benefits and pitfalls?
   c. Are cost segregation studies becoming the norm and what are the risks?
   d. What if the 100% bonus depreciation would cause a capital account issue – can the ownership entity elect to take some lesser amount of bonus depreciation or is it all or nothing? How does the ownership entity elect out of bonus depreciation?
   e. Can tax-exempt use property deals benefit from bonus depreciation? (Code §168(k)).
   f. How does the elimination of technical terminations impact bonus depreciation?

6. **Changes to Historic Rehabilitation Tax Credits** – Prior to Tax Reform, the 20% historic rehabilitation tax credit was 100% delivered on the day the building was placed in service. After Tax Reform, the 20% rehabilitation credit is delivered over a 5-year period beginning with the taxable year that the building is placed in service. Each year receives an amount of rehabilitation credit equal to its "ratable share" for such year. (Code § 47).
   a. How is ratable share computed?

b. Grandfathering for Buildings – Buildings which are owned during the entirety of the period after December 31, 2017 and with respect to which the 24-month rehabilitation period begins within 180 days of the December 22, 2017 enactment of the Tax Reform bill. How does the 24-mont period work? Does construction need to start?

7. **Revisions to Nonshareholder Capital Contributions** – What structuring changes are needed to LIHTC transactions in light of the explicit revision to Section 118 of the Code to provide that a nonshareholder contribution to capital of a corporation cannot include a contribution from a governmental entity or a civic group? Are energy rebates truly rebates or must they be characterized as income? (Code §118)

8. **What is the "BEAT"?** – Tax Reform created a new tax called the Base Erosion and Anti-Abuse Tax ("BEAT"). This is a tax on certain deductible payments paid or accrued by U.S. taxpayers to related foreign entities. For LIHTC projects, an investor subject to BEAT could lose up to 20% of the benefit of LIHTC through 2025 and may lose as much as 100% thereafter. Is the BEAT impacting LIHTC investors? (Code § 59A)

9. **Qualified Opportunity Zones** –Tax Reform created a tax incentive for investments in Qualified Opportunity Zones ("QOZs"). These tax benefits can be used for virtually any type of investment and can be "twinned" with other tax incentives. Although subject to complicated structuring, a subset of LIHTC, New Markets Tax Credit and Historic Tax Credit transactions could be combined with QOZs. (Code § 1400z-1 and § 1400z-2)
    a. Basic Overview - Taxpayers who have a gain from a sale or exchange of property ("Existing Gain") can qualify for 3 types of tax benefits if they invest the amount of gain in a fund that makes an investment in a Qualified Opportunity Fund (a "QOF"):
        i. Deferral of Tax on the Existing Gain – Existing Gain from the sale or exchange of property that is invested in a QOF within 180 days of such sale or exchange will have the tax due as a result of the Existing Gain deferred until the earlier of (i) December 31, 2026 or (ii) when the investment in the QOF is sold or exchanged. If the value of the investment has decreased on such date, then gain is based on the fair market value as of such date.
        ii. Permanent Reduction in Tax on the Existing Gain – A reduction of the deferred Existing Gain by 10% or 15% is available for investments in a QOZ Fund held for 5 or 7 years, respectively.
        iii. Permanent Avoidance on New Gain – Tax on profit generated from selling the investment in the QOF (new gain, as opposed to Existing Gain) is avoided entirely if the investment is held for 10 years through a step-up in the basis in the QOF.