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OPPORTUNITY ZONES & ECONOMIC DEVELOPMENT PROJECT FINANCING

Chair:
Kostas A. Poulakidas Taft Stettinius & Hollister LLP, Chicago, Illinois

Panelists:
Joseph (Jodie) E. Smith Maynard Nexsen PC, Birmingham, Alabama
Aileen Thomas Jones Walker LLP, Jackson, Mississippi

Designed for public finance attorneys, this panel will provide an overview of Qualified Opportunity Zones and Qualified Opportunity Zone Funds and how they are used within various economic development structures. This panel is intended to help public finance attorneys understand the basics of Qualified Opportunity Zones and how to discuss them with municipal and private sector clients who may also be including tax-exempt and taxable bond financing within their economic development projects.

In addition to Qualified Opportunity Zones, this outline provides as resource an overview of New Markets Tax Credits, Historic Tax Credits, Energy Tax Credits, Green and Social Impact Bonds, PACE Financing, and Low-Income Housing Tax Credits; however, the NABL panel will focus specifically on Qualified Opportunity Zones.

I. Qualified Opportunity Zones
II. New Markets Tax Credits
III. Historic Tax Credits
IV. Energy Investment Tax Credits
V. Green & Social Impact Bonds
VI. PACE Financing
VII. Low-Income Housing Tax Credits

I. QUALIFIED OPPORTUNITY ZONES

A. HISTORY AND SCOPE OF THE OZ STATUTE

- The Tax Cuts and Jobs Act of 2017 (the "TCJA") added Sections 1400Z-1 and 1400Z-2 (collectively, the "OZ Statute") to the Internal Revenue Code of 1986 (the "Code"). The broad policy behind the OZ Statute is to spur targeted economic and job growth by driving long-term capital to underserved communities in the United States and its territories.

- Unlike most other aspects of the TCJA, the concept of the OZ Statute originally enjoyed bipartisan support. Notably, Senators Scott (R-South Carolina) and Booker (D-New Jersey), as well as Representatives Tiberi (R-Ohio) and Kind (D-Wisconsin), championed a prior version of the legislation called the "Investing in Opportunity Act".[1] However, because the OZ Statute was ultimately passed as part of the TCJA, as opposed to being considered on a standalone basis (or as part of less controversial legislation), it ultimately lost some of its bipartisan support. Further, certain aspects of the original legislation that appealed to Democrats, most notably a reporting requirement, were not included in the final OZ Statute.

- The OZ Statute is similar in many respects to other tax incentives intended to spur economic development in distressed areas (e.g., the New Markets Tax Credit). For example, the eligibility requirements for census tracts to be designated as Qualified Opportunity Zones ("QOZs") generally is the same as the eligibility requirements for low-income tracts under the New Markets Tax Credit.

- Despite these similarities, the OZ Statute has the potential to attract a far larger pool of investors. Specifically, whereas the New Markets Tax Credit contemplates the allocation of a specified amount of tax credits pursuant to a competitive award process, the OZ Statute is available, without a cap, to any taxpayer who has realized capital gains. Some have estimated the pool of unrealized capital gains to be as high as *$6.1 trillion* – far exceeding the congressional allocation of tax credits under the New Markets Tax Credit program of *$5 billion* (as extended through 2025 by The Consolidated Appropriations Act, 2021 (P.L. 116-260).[2]

- Original estimates suggested that the OZ Statute would cost $1.6 billion in revenue from 2018-2027. As described below, the potential tax benefits afforded by the OZ Statute are predominately in the years following this window of time, e.g., after the 10-year holding period. New Treasury Regulations stipulate that the program's benefits would continue through 2047, meaning the program's revenue impact could increase over time depending on how many investors utilize the program.

- ***Takeaway:*** The breadth of the OZ Statute has the potential to cause an enormous amount of capital to flow into QOZs – which could result in a demonstrable positive impact for these communities. As discussed below, however, some of the initial bipartisan support of

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[1] H.R. 828 – 115th Congress (2017-2018). For an interesting article providing a history of the OZ Statute, including the involvement of Sean Parker from Napster and Facebook fame, *see* https://www.forbes.com/sites/forbesdigitalcovers/2018/07/17/an-unlikely-group-of-billionaires-and-politicians-has-created-the-most-unbelievable-tax-break-ever/#5c8430141485.

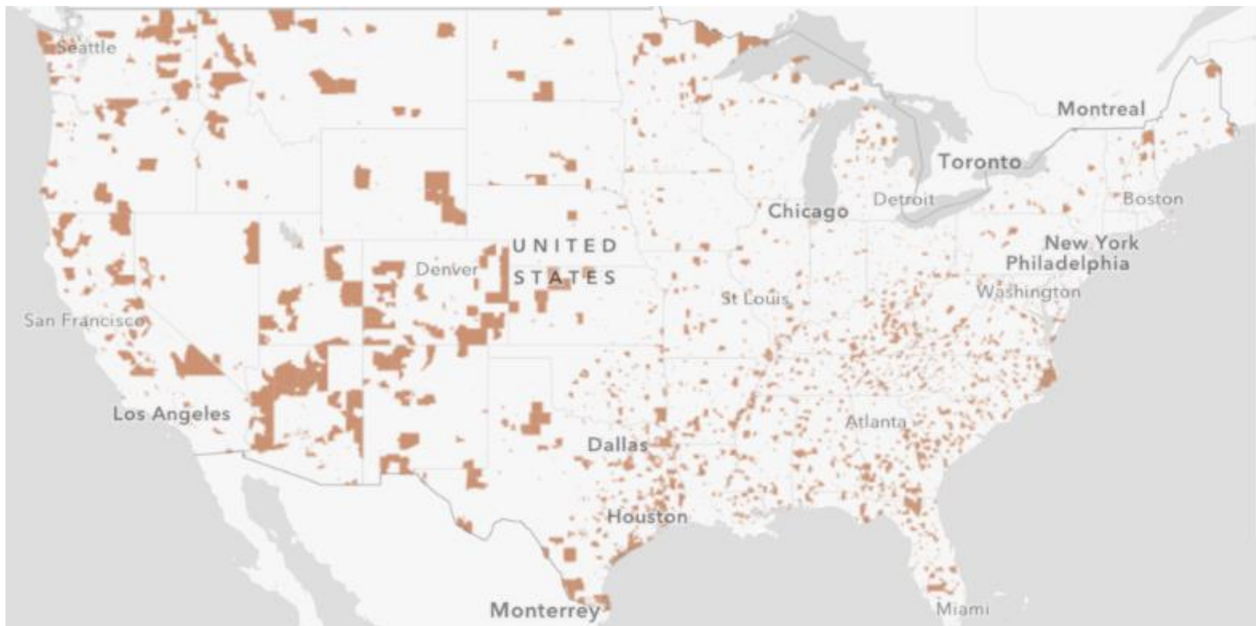
[2] *See* https://eig.org/news/opportunity-zones-tapping-6-trillion-market.

the OZ Statute has eroded as a result of the lack of reporting requirements and other concerns. As such, when discussing the OZ Statute with municipal issuers that have one or more QOZs in their jurisdictions, it is important to understand that not everyone sees this incentive (as currently enacted) as a positive for their communities.

B. WHAT ARE QUALIFIED OPPORTUNITY ZONES AND WHERE ARE THEY LOCATED?

- QOZs were identified by governors of each U.S. state or territory, often in consultation with local governments and, per press reports, sometimes in consultation with local developers, investors and business leaders. A list of all designated QOZs is available in IRS Notices 2018-48 and 2019-42.
- QOZs are comprised of:
  - Low-Income Community Tracts – Census tract poverty rate is at least 20% or median family income for the tract does not exceed 80% of the area median family income (Currently 25% of QOZs in each state are designated as Low-Income Community Tracts (LICs), but the Expanding Opportunity Zones Act of 2021 (HR 4177) introduced by Jim Hagedorn (R-MN) proposes to expand the LICs to 30% of QOZs in each state), and
  - Eligible Contiguous Non-Low-Income Tracts – Contiguous census tracts where the median family income for the tract does not exceed 125% of the area median family income (limited to 5% of total QOZs within a state).
- Over 8,700 QOZs have been designated in the U.S. and territories.[3] California has the most QOZs (879); the U.S. Virgin Islands has the least (14).

[3] *See* https://www.enterprisecommunity.org/opportunity360/opportunity-zone-eligibility-tool for an interactive map of QOZs, a portion of which appears herein (but note the map does not include all designated QOZs, as Alaska, Hawaii, and U.S. territories are not reflected). Note that the larger QOZs identified on the map, particularly in western states, reflect the size of the census tract; there is no correlation to the number of residents that live in such areas.



- Neither the OZ Statute nor the Treasury Regulations promulgated thereunder include an ability to designate additional QOZs nor the ability of a QOZ to lose its status (for example, if the census tract income increases).
- ***Takeaway:*** There are QOZs in every state, including both rural and urban areas. State and local governments took different approaches to designating census tracts (e.g., strict adherence to the policy goals of legislation compared to likelihood of seeing actual investments). When talking with municipal clients, it may be important to understand the approach taken when potential QOZs were identified.

C. THE OZ STATUTE'S THREE TAX BENEFITS – DEFERRAL, REDUCTION, AND EXEMPTION

- ***Deferral of Current Capital Gains Tax***: A U.S. taxpayer that makes an equity investment of recognized capital gain in a Qualified Opportunity Fund ("QOF") during the 180-day period following such recognition is eligible to defer the resulting capital gains tax until the earlier of (i) the date the QOF investment is sold (or an "inclusion event" occurs) and (ii) December 31, 2026.[4] The Expanding Opportunity Zones Act of 2021 (HR 4177) introduced by Jim Hagedorn (R-MN) proposes to extend the deferral date to December 31, 2029, and the Opportunity Zone Extension Act of 2021 introduced by Tim Burchett (R-TN) and Henry Cuellar (R-TX) proposes to extend the deferral date to December 31, 2028.
    - If the QOF investment is sold for cash on or before December 31, 2026, then the taxpayer presumably will have the liquidity to pay the deferred tax liability.

[4] Taxpayers that invest eligible gain in a QOF are required to file IRS Form 8997, Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments (*see* https://www.irs.gov/pub/irs-dft/f8997--dft.pdf).

However, if the taxpayer holds the QOF investment through December 31, 2026, the taxpayer will have to consider the consequences of having "phantom income."

- ***Reduction of Tax on Capital Gains***: If the taxpayer holds the QOF investment for 5 years, 10% of the deferred capital gain is added to the taxpayer's basis in the QOF investment – resulting in a 10% permanent reduction of the taxpayer's deferred capital gain. *NOTE: Under current law, QOZ investments after December 31, 2021 do not receive the basis adjustment; however, there is proposed legislation in Congress that may revive the basis adjustment benefit.*

- ***Appreciation on QOF Investment is Permanently Exempt from Tax***: A QOF investor that holds its QOF investment for at least 10 years can elect to increase its basis in the QOF investment up to an amount equal to the FMV on the eventual date of sale, resulting in 100% exemption from tax on the appreciation.
    - Most see this as the OZ Statute's primary tax benefit. However, the taxpayer must be willing/able to hold the QOF investment for at least 10 years to enjoy this benefit, which may be longer than its usual holding period.

- ***Takeaway:*** The OZ Statute has the ability to confer significant tax benefits upon taxpayers. In addition to deferring and reducing the original capital gain, imagine if an investor in a successful startup (e.g., Facebook) was able to eliminate 100% of the tax on the appreciation of its investment! That said, the tax benefits under the OZ Statute do not make bad investments good (paying tax is typically better than losing money), so the same diligence that would be conducted for a non-QOF investment should be done when considering a QOF investment. Interested taxpayers should consult with qualified CPAs and/or other tax advisors who understand the OZ Statute to assess the viability of an investment in a QOF and its potential tax implications.

D. OVERVIEW OF THE OZ STATUTE

Warning: As described under Part VI below, the OZ Statute omitted many specifics, leaving it to the IRS and Treasury to fill in the gaps via Treasury Regulations.[5] A detailed review of all of the nuances of the OZ Statute, as modified by the Final Regulations, is beyond the scope of this presentation. Rather, the general summary of the OZ Statute set forth below is intended to provide public finance attorneys with a general understanding of the rules so that they can effectively communicate with public finance clients at a high level. Practitioners who specialize in the OZ Statute should be consulted for more detailed discussions with clients and potential clients.

Illustration of the General Concept

[5] For example, the term "substantially all" is used but not defined several times in the Code. Similarly, the Final Regulations "override" the Code in some respects (e.g., a de minimis amount of "sin business" activity is permitted despite the plain language of the Code, and a QOF can lease property in certain instances despite the use of the term "by purchase" in the Code).

- ***QOF***: A QOF is an investment vehicle that:
    - Is organized as a domestic corporation or a partnership for federal tax purposes (can be an LLC as long as it is not disregarded for federal tax purposes);
    - Is organized for the purpose of investing in Qualified Opportunity Zone Property ("QOZP") (other than another QOF); and
    - Holds at least 90% of its assets in QOZP, determined by the average of the percentage of QOZP held in the QOF as measured every 6 months, including after the first 6 months of QOF's taxable year and at the end of each taxable year.[6]
- ***QOZP***: QOZP can be direct ownership of Qualified Opportunity Zone Business Property ("QOZBP") or indirect ownership of QOZBP through the ownership of an intermediary entity that operates as a Qualified Opportunity Zone Business ("QOZB").
- ***QOZBP***: QOZBP is tangible property used in a trade or business if the following requirements are met:
    - The QOF acquires such property by purchase after December 31, 2017, from an unrelated party (20% related party definition);
    - The original use of such property in the QOZ commences with the QOF or the QOF substantially improves the property; and
    - During 90% of the QOF's holding period for such property, 70% of the use of such property was in a QOZ.
- ***QOZB***: A QOZB means a trade or business that meets the following requirements:
    - 70% of the tangible property owned or leased by the business is QOZBP (determined by substituting QOZB for QOF in the definition above);
    - At least 50% of the business's total gross income is from the active conduct of its business;
    - 40% of the intangible property of such business is used in the active conduct of a trade or business;

[6] There is not an advance approval process to be certified as a QOF. Rather, an entity self-certifies its QOF status by filing IRS Form 8996, Qualified Opportunity Fund (*see* https://www.irs.gov/forms-pubs/about-form-8996).

    - Less than 5% of the average of the aggregate unadjusted bases of the property of such business is attributable to nonqualified financial property; and
    - The business must not be a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

- ***Takeaway:*** The OZ Statute contains very few requirements relating to the types of property or businesses that can qualify for purposes of the QOF's 90% ownership test. The general lack of restrictions has the ability to spur substantially more economic development than other types of tax incentives; however, the lack of restrictions also creates the potential for investments that do not further the stated policy of the OZ Statute.

E. THE OZ STATUTE TREASURY REGULATIONS

- When signed into law in December 2017, the OZ Statute was met with great enthusiasm from a wide variety of groups, including investors, funds, real estate developers and operating businesses, as well as state and local governments that have one or more QOZs within their jurisdictions; however, the OZ Statute was limited in the specifics it provided and the IRS and Treasury have come out with multiple interpretive guidance documents related to the OZ Statute.

- ***First Tranche***: The first tranche of proposed Treasury Regulations concerning the OZ Statute (the "First Tranche") was published in the Federal Register on October 29, 2018. Among other areas, the First Tranche addressed the following items:
    - Types of gain that may be deferred;
    - Expiration of the 10-year exemption;
    - Types of taxpayers that can take advantage of the OZ Statute;
    - How a fund qualifies as a QOF; and
    - Additional helpful guidance regarding QOZP, QOZBP, and QOZBs.

  Although the First Tranche answered some of the questions left open in the OZ Statute, in many instances it caused even more issues with respect to the OZ Statute's application. Thus, those who were otherwise enthusiastic about the OZ Statue continued to be hesitant to actually move forward with investments and projects.

- ***Second Tranche***: The second tranche of proposed Treasury Regulations (the "Second Tranche") was published in the Federal Register on May 1, 2019. Among other areas, the Second Tranche addressed the following items:
    - The treatment of land as QOZBP;
    - What constitutes "original use" of tangible property for purposes of the substantial improvement requirements (including provisions relating to vacant property);
    - The treatment of leased property;
    - Valuation of QOZBP for purposes of QOFs and QOZBs (including a helpful safe harbor for newly contributed investments);

- The definitions of "substantially all" in the various places it is used in the OZ Statute;
- Guidance regarding property that straddles a QOZ;
- What constitutes the receipt of gross income from the "active conduct of a trade or business in the QOZ" (including the helpful addition of three safe harbors);
- Sourcing of gross income of a QOZB to a QOZ;
- The ability of a QOF to sell QOZBP after 10 years;
- Whether debt is included in the tax basis for a QOF investor's interest in a QOF partnership;
- Whether carried interest is eligible for QOZ benefits;
- How Section 1231 gain is treated;
- Events that end a QOF investor's gain deferral; and
- Reinvestment by a QOF of proceeds from a sale of QOZBP or an interest in a QOZB.

While questions remained, the Second Tranche provided sufficient clarity for some hesitant taxpayers to move forward with QOF investments. This was particularly the case for investors seeking to obtain the full 15% basis increase for QOF investments held for 7 years, as such investments had to be made by December 31, 2019. *NOTE: Under current law, QOZ investments do not receive the basis adjustment; however, there is proposed legislation in Congress that may revive the basis adjustment benefit.*

- ***Final Regulations***. On December 19, 2019, the IRS and Treasury released final Treasury Regulations (the "Final Regulations") that merge the First Tranche and the Second Tranche into a single set of regulations, as well as make additional changes.[7] The Final Regulations were published in the Federal Register on January 13, 2020. Among other issues, the Final Regulations address the following items:
  - What types of gains may be invested and when;
  - Additional guidance regarding Section 1231 gain;
  - The start of the 180-day investment period for partners in a partnership, shareholders of S corporations, and beneficiaries of estates and complex trusts;
  - RIC and REIT gains;
  - Installment sale gains;
  - Guidance for nonresident aliens with effectively connected income;
  - When gains may be excluded from tax after an investment is held for a 10-year period;
  - When purchased original use assets that improve the functionality of non-original use assets in the same QOZ or a contiguous QOZ can be taken into account;

[7] T.D. 9889.

- When a group of two or more buildings located on the same parcel(s) of land can be treated as a single property;
  - Revised guidance regarding vacant property;
  - Revised guidance regarding leasing activity;
  - Several refinements to the working capital safe harbor set forth in the prior guidance;
  - A clearer way for determining satisfaction of the substantial use test applicable to QOZBs, including a safe harbor for certain tangible property used both inside and outside the geographic borders of a QOZ;
  - Guidance regarding determinations of location and "use" of intangible property;
  - A square footage test and an unadjusted cost test to determine if a project is primarily in a QOZ;
  - Guidance that parcels or tracts of land will be considered contiguous if they possess common boundaries, and would be contiguous but for the interposition of a road, street, railroad, stream or similar property;
  - Application of the straddle rules to QOFs and QOZBs;
  - Guidance regarding Brownfield sites;
  - Guidance that self-constructed property can count for purposes of a QOF's asset test and a QOZB's asset test;
  - Guidance that allows for a de minimis amount of "sin business" activity; and
  - Guidance regarding unimproved land, demolition of existing property, self-constructed property, and inventory in transit.
- ***Regulations related to Covid-19 Pandemic***: Additionally, the Covid-19 pandemic resulted in relief, deadline extension and other modifications of how the OZ Statute was to be implemented during this period. These modifications are extensive; see these IRS Notices for additional information:
  - Notice 2020-39, Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic
  - Extension of Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic to the Opportunity Zone (Notice 2021-10)

F. INTERSECTION BETWEEN PUBLIC FINANCE AND OPPORTUNITY ZONES

- The OZ Statute does not create a governmental "program" – rather, it is simply a tax incentive under the Code intended to unlock and direct private capital towards QOZs and potentially encourage public-private partnerships ("P3s") and foster economic development. QOFs and the property and businesses in which they invest typically have no actual governmental involvement.
- Tax-exempt bonds can be used to complement investments in QOZs. As a result, many public finance attorneys will be asked about the OZ Statute by a variety of clients, including

(but not limited to) affordable housing developers, private entities interested in IDBs for manufacturing facilities or that might otherwise benefit from exempt facility bonds, as well as state and local governments that have a QOZ within their jurisdiction.

- Affordable housing projects were some of the first that received QOF interest because, for the most part, they neatly fit within the OZ Statute; additional guidance from the IRS and Treasury was needed for most other operating businesses. It would be entirely possible for an affordable housing project's capital stack to include proceeds of exempt facility bonds for qualified residential rental projects under Section 142(d) of the Code, equity investments relating to the Low Income Housing Tax Credit, plus investments from QOFs.
- In addition to affordable housing, various entities that can borrow proceeds of IDBs, sewage facility bonds, and/or solid waste disposal facility bonds have expressed interest in pursuing QOF investments.
- Governmental units that have one or more QOZs located in their jurisdiction should consider what role they can play in attracting investments resulting from the OZ Statute in order to produce clear and unambiguous policies that the private sector may rely upon in determining investment opportunities in a QOZ.
- In addition to promoting the QOZs, a state and local government can use additional means to make the projects more attractive to opportunity zone investors and potentially increase the internal rate of return. For example, tax-exempt obligations could be issued to finance improvements intended to help the QOF succeed, such as those for streets and sidewalks, utilities, schools and community colleges, public safety, greenspace and area beautification, among several others. The government also could offer additional incentives to spur investment, such as issuing economic development bonds and/or other means of tax increment financing, property tax abatements and efficient governmental approvals and permits.

Takeaway: A general understanding of the OZ Statue will help public finance attorneys effectively counsel their clients and provide valuable insight to help them with economic development project financing.

II. NEW MARKETS TAX CREDITS

A. Overview.[8] The New Markets Tax Credit ("NMTC") program permits taxpayers to receive a credit against Federal income taxes for making qualified equity investments ("QEIs") in designated Community Development Entities ("CDEs"). Substantially all of the QEI must in turn be used by the CDE to provide qualified low-income community investments ("QLICIs") in low-income communities. The credit provided to the investor totals 39% of the cost of the investment and is claimed over a seven-year credit allowance period. The credit allowance date means, with respect to any QEI, (i) the date on which such investment is initially made and (ii) each of the six anniversary dates of such date. In each of the first three credit allowance dates, the investor receives a credit equal to 5% of the total amount paid to the CDE for the QEI at its original issue. For each of the final four credit allowance dates, the value of the credit is 6%. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period but are permitted to sell their interest with the credits still available.

Similar to tax-exempt bond financing, the investor receives the actual tax benefit in the form of tax credits, while the project owner/borrower gets the economic benefit of the credits through more favorable loan terms available because the investor's return comes partially through the credits.

B. Law. Section 121(a) of the Community Renewal Tax Relief Act of 2000 (Pub. L. 106-554), enacted on December 21, 2000 (the "NMTC Act"), amended the Code by adding Code Section 45D, New Markets Tax Credit. The program has been extended several times as part of several dozen of the so-called "tax extenders." The program was most recently renewed through the Consolidated Appropriations Act, 2021. This Act included a five-year, $25 billion extension of the program. The New Markets Tax Credit Extension Act of 2023 (S.234/H.R. 2539), introduced in the Senate/House this year, would make the NMTC permanent if adopted. The related regulations are found at Treasury Regulations ("Treas. Reg.") Section 1.45D-1, et seq. A portion of the NMTC program is administered through the Community Development Financial Institutions Fund ("CDFI Fund") of the U.S. Treasury Department. Guidance published by the CDFI Fund on how an entity may apply to become certified as a CDE is found at 66 **Federal Register** 65806 (December 20, 2001).

C. Allocation of New Markets Tax Credits. The NMTC Act did not provide a required process for allocating the NMTCs and there are no statutory suballocations to States. The CDFI Fund was tasked with making allocations of credits to CDEs. The CDFI Fund provides two functions. First, the CDFI Fund certifies organizations as qualifying CDEs. Second, it makes the allocations of NMTCs upon application by the CDEs. The CDFI Fund is responsible for establishing the credit application process, eligibility guidelines, and a scoring model for ranking applicants requesting allocations of NMTCs.

In making the allocations described in the preceding sentence, the CDFI Fund is required to give priority to any entity (i) with a record of having successfully provided capital or technical

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[8] Note: See IRS Publication entitled New Markets Tax Credit LMSB-04-0510-016 (May 2010), www.irs.gov/pub/irs-utl/atgnmtc.pdf for an IRS summary of the program.

assistance to disadvantaged businesses or communities or (ii) which intends to make QLICIs in one or more businesses in which persons unrelated to such entity hold the majority equity interest.

The amount of available allocation is limited by statute. The amount has been increased in the past to address need for recovery after natural disasters (GO Zone allocations) and economic distress (American Recovery and Reinvestment Act – ARRA).

Once a CDE has applied for, and received, an allocation, it enters into an agreement with the CDFI Fund relating to that allocation, which includes requirements as to how quickly that allocation must be used and the terms and conditions of the allocation. Typically, the CDE has two years to use at least 60% of such allocation to make a QEI, and, under IRC §45D(b)(1), must use all of its allocation within five years after it signs the allocation agreement with the CDFI Fund.

D. Key Terms in NMTC Transactions.

1. *CDEs:* Under IRC § 45D(c)(1), a CDE is any domestic corporation or partnership:

(a) Whose primary mission is serving or providing investment capital for low-income communities or low-income persons;

(b) That maintains accountability to residents of low-income communities through their representation on any governing board or advisory board of the CDE; and

(c) Has been certified as a CDE by the CDFI Fund.

Under IRC § 45D(c)(2), any specialized small business investment company as defined in IRC § 1044(c)(3) and any CDFI as defined in § 103 of the Community Development Banking and Financial Institutions Act of 1994 is treated as having met these requirements. A CDE certification lasts for the life of the organization unless it is revoked or terminated by the CDFI Fund. To maintain its CDE certification, a CDE must certify annually during this period that the CDE has continued to meet the CDE certification requirements.

Both for-profit and non-profit CDEs may apply to the CDFI Fund to be certified and to receive an allocation of NMTCs, but only a for-profit CDE is permitted to provide the NMTCs to its investors. Thus, if a non-profit CDE receives an allocation of NMTCs, it must "suballocate" its NMTC allocation to one or more for-profit CDEs.

A governmental unit is not eligible to be certified as a CDE because it is not a domestic corporation or partnership under federal tax law, so it must form a separate entity (non-profit or for-profit) if it wishes to be a CDE. Single member LLCs of governmental units do not qualify either. Many State and local governments and 501(c)(3) organizations have formed CDEs and have obtained an allocation of NMTCs over the years.

Most CDEs with an allocation of NMTCs will create a separate single-purpose sub-CDE for each project, "sub-allocating" NMTCs for the project in this manner.

2. *QEIs:* The tax credit is calculated based on the amount of the QEI made in a CDE. Under IRC § 45D(b)(1), a QEI is, in general, any equity investment in a CDE if all of the following requirements are met:

(a) Such investment is acquired by the investor at its original issue (directly or through an underwriter) solely in exchange for cash;

(b) Substantially all (at least 85%) of the cash is used by the CDE to make a QLICI; and

(c) The investment is designated by the CDE as a QEI on its books and records using any reasonable method.

The term "equity investment" means any stock in an entity that is a corporation, and any capital interest in an entity that is a partnership for federal tax purposes.

With respect to (a) above, the IRS ruled in Revenue Ruling 2003-20, 2003-1 C.B.-465, that funds derived from a loan (the so-called "Leverage Loan") made to the investor will meet the requirement of a cash investment, subject to certain conditions. The Leverage Loan will typically be nonrecourse to the investor, secured solely by the investor's interest in the CDE. The primary requirement is that the Leverage Loan cannot be secured by the project being financed or the assets of the borrower. The Leveraged Loan model has become the standard for many NMTC transactions, with the Leverage Loan being sourced from funds that might otherwise have gone directly into the projects. The source of the Leveraged Loan has ranged from taxable loans, capital campaign contributions, federal or state grants, equity of parties related to the QALICB (as defined in Section 3(a) below), low interest loans from mission-driven organizations, USDA guaranteed loans, and, in some instances, tax-exempt bond proceeds. Any requirements that might otherwise have been placed on the use of the funds being leveraged must be monitored indirectly through the CDE which is the actual lender to the QALICB in the NMTC structure. The leverage lender will typically be asked to forbear on exercising remedies against the investor during the NMTC Compliance Period, as defined in Section 4(c) below. Most investors will require that the leverage lender and the QALICB be separate entities in order to conclude that the NMTC structure has been respected and that the Leverage Loan is not a direct loan to the QALICB which would not qualify for NMTCs. Counsel take different views on the extent of overlapping control between a leverage lender and a QALICB.

With respect to (c) above, the CDE is able to designate QEIs only up to the limit of the NMTC allocation it has received.

3. *QLICIs*: As indicated above, under the QEI requirements substantially all of the QEI must be used to make a QLICI. The investor's cash investment received by a CDE is treated as invested in a QLICI only to the extent that the cash is so invested no later than twelve months after the date the cash is paid by the investor (directly or through an underwriter) to the CDE. The cash investment can be one of the four following types of QLICIs under IRC § 45D(d)(1):

(a) Any capital or equity investment in, or loan to, any qualified active low-income community business ("QALICB").

(b) A loan purchased by a CDE from another CDE which is a QLICI.

(c) Financial counseling and other services to any QALICB, or to any residents of a low-income community.

(d) Any equity investment in, or loan to, other CDEs.

See Treas. Reg. § 1.45D-1(d)(1)(iv).

4. *QALICBs*: Under IRC § 45D(d)(2)(A), a QALICB, is, for any tax year, a corporation (including a nonprofit corporation) or partnership if, for the year, all of the following requirements are met:

(a) at least 50% of the total gross income of the entity is derived from the active conduct of a qualified business within low-income communities;

(b) a substantial portion (at least 40%) of the use of the entity's tangible property (whether owned or leased) is within low-income communities;

(c) a substantial portion (at least 40%) of the services performed for the entity by its employees are performed in low-income communities;

(d) less than 5% of the average of the aggregate unadjusted basis of the entity's property is attributable to collectibles, other than those held primarily for sale to customers in the ordinary course of the business; and

(e) less than 5% of the average of the aggregate unadjusted basis of the entity's property is attributable to "nonqualified financial property" (i.e. investment assets such as debt instruments not issued in the ordinary course of business, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts or annuities), except that such term does not include (i) reasonable amounts of working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less, or (ii) certain debt instruments.

A QALICB includes a business carried on by an individual as a proprietor if the business, were it incorporated, would meet the above requirements for corporations and partnerships. A so-called "portion of a business" may also qualify as a QALICB if the portion would meet the requirements of a QALICB if it were separately incorporated and it maintains a complete and separate set of books and records for the portion of the business.

A "qualified business" is any trade or business, subject to certain restrictions described below. The rental to others of real property is treated as a qualified business if and only if (i) the property is not residential rental property and (ii) there are substantial improvements located on such property. A "qualified business" does not include (i) any trade or business consisting predominantly of the development or holding of intangibles for sale or license, (ii) any trade or business consisting of the operation of a facility for any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises, or (iii) any trade or business the principal activity of which is farming (with certain de minimis exceptions).

These QALICB requirements are very similar to the requirements of an "enterprise zone business" under Section 1394 of the Code for purposes of enterprise zone facility

bonds, but without the requirement that 35% of the employees be residents of the enterprise zone.

In general, the QALICB test is based on reasonable expectations at the time the QLICI is made that the requirements will be met throughout the 7-year compliance term (the "NMTC Compliance Period"). If the CDE obtains control of the QALICB at any time during the NMTC Compliance Period, the determination of QALICB status is made based on actual facts.

A governmental unit cannot qualify as a QALICB because it is not a trade or business for Federal tax purposes. In order to finance typical governmental projects through the NMTC program, the governmental unit may form a separate for-profit or nonprofit entity to serve as the QALICB project owner and borrower. A governmental entity may be the lessee of the QALICB's project under a true lease. A financing lease would likely result in the lessee/governmental unit being treated as the QALICB (which is not a qualified business) or the lease could be treated as a loan to the governmental unit, causing the QALICB to exceed the 5% "nonqualified financial property" test described above.

5. *Low-income community*: IRC § 45D(e)(1) defines a "low-income community" as any population census tract where the poverty rate for such tract is at least 20%, or in the case of a tract not located within a metropolitan area, median family income for such tract does not exceed 80% of statewide median family income, or in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80% of the greater of statewide median family income or the metropolitan area median family income.

As part of the American Jobs Creation Act of 2004, IRC § 45D(e)(2) was amended to provide that targeted *populations* may be treated as low-income communities. A "targeted population" means individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. "Targeted population" also includes the Hurricane Katrina Gulf Opportunity (GO) Zone, where individuals' principal residences or principal sources of income were located in areas that were flooded, sustained heavy damage, or sustained catastrophic damage as a result of Hurricane Katrina. Final regulations on targeted populations under Treas. Reg. § 1.45D-1 were published at 76 Federal Register 75774 (December 5, 2011).

The CDFI Fund and the IRS have agreed as to the source of information regarding qualification of a census tract. The qualification information is available by entering an address on the CDFI Fund web page (www.cdfifund.gov). In general, the census information in place when the QLICI is made will govern throughout the NMTC Compliance Period, even if the census tract lines or characteristics change during that period. The CDFI Fund also has compliance Questions and Answers which address particular problems related to determining the qualification of a census tract.

E. Recapture. Section 45D of the Code contains extensive recapture provisions. If, at any time during the NMTC Compliance Period beginning on the date of the original issue of a QEI in a CDE, there is a "recapture event" with respect to such investment, then the tax imposed

for the taxable year in which such event occurs shall be increased by the "credit recapture amount." A recapture event occurs for a CDE if:

(1) the entity ceases to be a qualified CDE;

(2) substantially all of the proceeds of the investment cease to be used by the entity to make QLICIs; or

(3) a QEI is redeemed by the entity.

With respect to (2) above, any repayments of principal during the NMTC Compliance Period, including recovery from foreclosure, must be reinvested such that the 85% substantially all test is met. Failure of the borrower to qualify as a QALICB could also trigger recapture. In the case of an investor formed as a partnership, distributions from the CDE in excess of amounts described in Treas. Reg. § 1.45D-1(d)(1)(iv) are treated as a redemption of a QEI.

If there is a credit recapture event for an investment at any time during the NMTC Compliance Period, the tax payable by the holder of the equity interest for the tax year in which the event occurs is increased by an amount known as the "credit recapture amount," and no further credits are allowed. The credit recapture amount is equal to the increase in a taxpayer's general business credit attributable to the NMTCs used by the taxpayer to reduce tax liability for all years prior to the recapture event, plus interest at the underpayment rate for the resulting underpayment in tax for these years.

The investor will require indemnification of recapture amounts from both the CDE and the QALICB for certain specified recapture events.

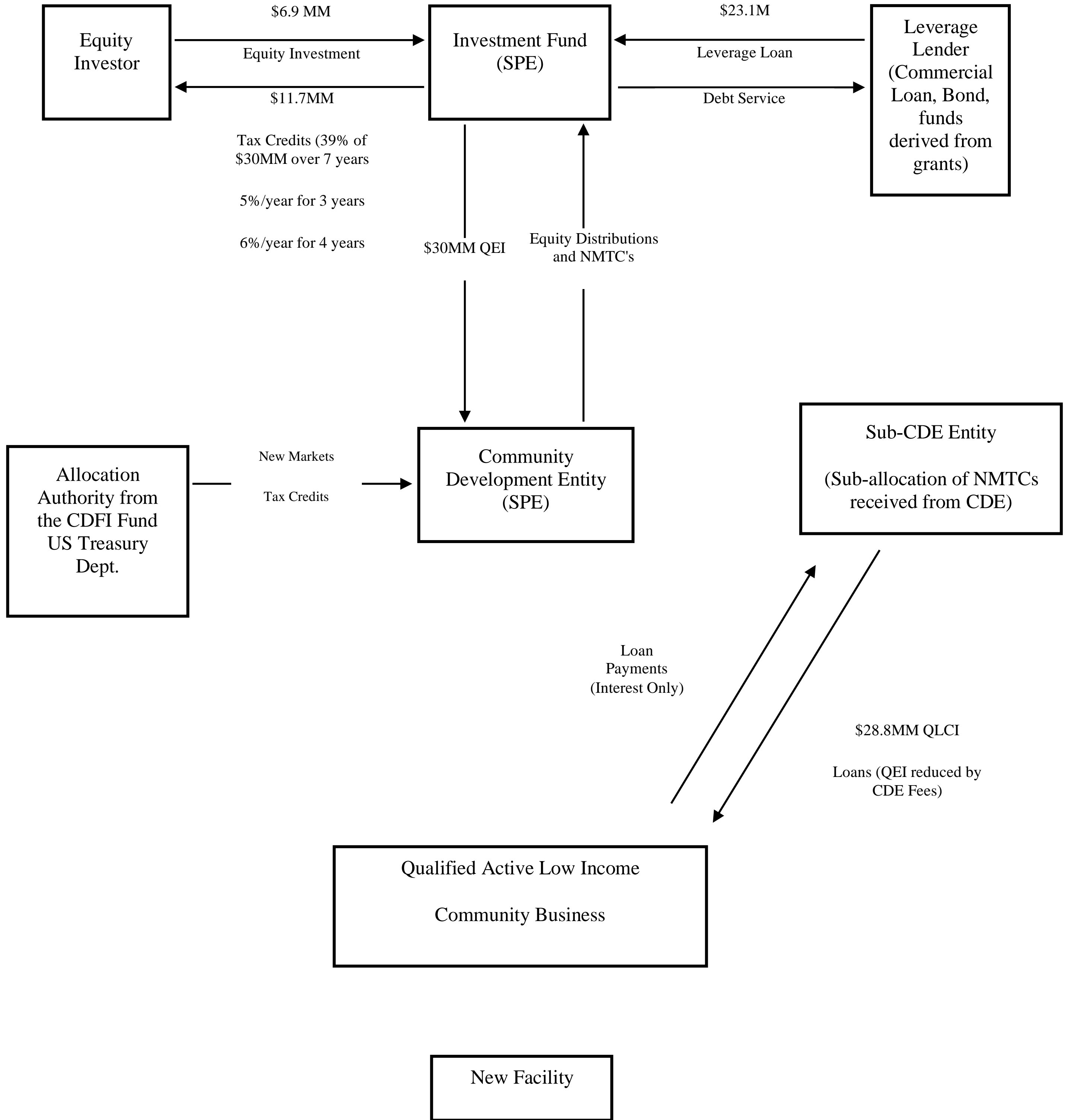
F. Fundamental Economics.

NMTCs reduce a taxpayer's tax liability on a dollar-for-dollar basis. The tax credit, unlike historic tax credits or low income housing tax credits, arises from the investment in the CDE which then sub-allocates the allocation to a single-purpose entity created by the CDE to act as the lender in the structure (the Sub-CDE). The Sub-CDE makes the QLICI, rather than from participation in a partnership or LLC that owns the asset itself. The Investment Fund makes a capital contribution (i.e., the QEI) into the CDE, and the CDE allocates the tax credit to the investor over a period of seven years. The CDE must use the QEI to make a QLICI (loan or investment in a qualifying business or project) at below market terms or rates.

In order for the investor to get a return for its investment, it needs to pay less than $1.00 for each dollar in tax credit. To achieve that, in the "Leverage Loan model" a third-party lender or the sponsor lends money into the structure through a loan to a single-purpose LLC created by the NMTC investor (the "Investment Fund") which is combined with the equity of the investor to fund the QEI. The lender ("leverage lender") is paid interest at a market rate during the seven-year tax credit period (or at a lower interest rate if the leverage lender is not a commercial lender); the tax credit investor gets the tax credit. The leverage lender needs to forbear for 7 years, and the leverage loan cannot be collateralized by the assets of the QALICB. The addition of the Leverage Loan proceeds increases the amount of NMTCs for which the transaction is eligible and the availability of the cash from the investor reduces the interest rate passed through by the CDE because the amount of funds coming from distributions from the CDE needs to be sufficient to pay only the Leverage Loan.

The following chart shows the fundamental structure of the NMTC with a Leverage Loan (bank loan or tax-exempt or taxable bonds). Note that the CDE is making a suballocation of NMTCs to the Sub-CDE. The Sub-CDE then makes a loan to the QALICB using both the proceeds of the QEI, which was funded by the investor equity contribution and the proceeds of a Leverage Loan. In most cases, the Leverage Loan is sourced with a taxable loan. However, because of the advantages of issuing tax-exempt bonds as compared to taxable loans, there is increased attention to the possibility that the Leverage Loan to the QALICB from the CDE could be funded from the proceeds of tax-exempt bonds. The QALICB oftentimes will develop and construct the New Facility and then lease the New Facility to the sponsor or Leverage Lender.

$30,000,000 Investment through New Markets Tax Credit Structure



G. Combining other Tax Benefits with NMTCs, including Tax-Exempt Bonds. IRC § 45D(i) authorizes the Secretary of the Treasury to promulgate regulations appropriate to carry out the purposes of the NMTC program, including regulations which limit the credit for investments which are directly or indirectly subsidized by other federal tax benefits (including the credit under Section 42 and the exclusion from gross income under Section 103). Thus, the analysis of what combination of benefits would be available focuses both on the NMTCs and the rules applicable to the other tax benefit. The IRS issued a notice of proposed rulemaking and proposed regulations before finalizing the regulations under Treas. Reg. § 1.45D-1((g)(3). The final regulations take the approach that the benefit of NMTCs is not limited except as specifically provided. The final regulations state that NMTCs cannot be used together with low income housing tax credits under Section 42 of the Code. A capital or equity investment or a loan by a CDE with respect to a qualified low-income building under Section 42 of the Code is not a QLICI to the extent the building's eligible basis under Section 42(d) of the Code is financed by the proceeds of the investment or loan. Federal tax benefits that do not limit the availability of NMTCs include, for example, (i) the rehabilitation credit under Section 47 of the Code, (ii) all deductions under Sections 167 of the Code and 168 of the Code, including the additional first-year depreciation under Section 168(k) of the Code, and the expense deduction for certain depreciable property under Section 179, and (iii) all tax benefits relating to certain designated areas such as empowerment zones and enterprise communities under Sections 1391 through 1397D of the Code, the District of Columbia Enterprise Zone under Sections 1400 through 1400B of the Code, renewal communities under Sections 1400E through 1400J of the Code, and the New York Liberty Zone under Section 1400L of the Code. The latter category encompasses several tax benefits, including tax-exempt bonds, in part because the qualified business requirements of these provisions are similar to the QALICB requirements of Section 45D of the Code. Through the NMTC regulation process, the IRS did not identify any examples of how tax-exempt bonds and NMTCs would produce "double-dipping".

Low income housing tax credits under Section 42 of the Code are the only specific limitation in the Treas. Reg. In any tax-exempt bond issue, it is important to determine how the proceeds of the bonds are used. The uses determine the qualification of the bonds for tax-exempt treatment and the nature of that exemption. For some types of issues, as described below, the characterization of the CDE as a taxable entity (as required for the NMTC transaction) is not problematic for the tax analysis on the tax-exempt bonds. For example, use of private activity manufacturing bonds as a source of the Leverage Loan is consistent with the characterization of the NMTC tax analysis. However, for other types of tax-exempt bonds where private use is not permitted or the private use must be 501(c)(3) use, the bond analysis of the use of tax-exempt bonds or tax credit bonds to make the Leverage Loan which ultimately flows down the NMTC structure to the QALICB to fund the project may complicate the required NMTC tax analysis that the Leverage Loan is true debt to the Investment Fund.

1. The essential issue raised in the use of tax-exempt bonds arises from the NMTC structure itself. If the bond proceeds are being used as the source of the Leverage Loan, bond counsel must be able to conclude that the ultimate use of the proceeds is the determining factor. In the NMTC structure, the bond proceeds are first loaned to the Investment Fund who then uses the proceeds of the Leverage Loan (together with the investor equity) to make a QEI in a CDE. While the investor must be a private business if it is to be able to obtain the tax benefit of the NMTC, the proceeds at that point are being used to purchase an investment (i.e. the QEI), not to build a project. The CDE then uses the proceeds of the QEI to make a QLICI to the QALICB.

The proceeds of the QLICI are then used by the QALICB to finance a project. The CDE is also required by the NMTC rules to be a for-profit business and it is required to use the proceeds of the QEI to make a QLICI (i.e. a loan to, or purchase an equity investment in) to a QALICB. Once the CDE makes the QLICI, the ultimate use of the proceeds can be determined. On the other hand, counsel to the NMTC investor must conclude that the loan of the bond proceeds (i.e. the Leverage Loan) to the Investment Fund is a true debt of the Investment Fund, because the NMTC structure does not permit a direct loan of the bond proceeds to the QALICB. The ultimate use analysis which gives bond counsel comfort is a different analysis than that of the NMTC counsel who must be comfortable that the three levels of the NMTC structure remain separate.

2. Some bond counsel have focused on the private business test and concluded that there are generally no issues presented by funding the Leverage Loan with the proceeds of private activity bonds (other than qualified 501(c)(3) bonds), such as enterprise zone bonds (Code Section 1394), and solid waste disposal bonds (Code Section 142). During recent years, recovery zone facility bonds (Code Section 1400U-3), Midwest disaster area bonds (Code Section 1400N), Qualified Energy Conservation Bonds ("QECBs") under Section 54D and Qualified School Construction Bonds ("QSCBs") under Code Section 54F have also been used because these categories all permit private business use. This conclusion must still rely to some extent on the ultimate use analysis to conclude that proceeds were used to build a project that meets the bond qualifications.

3. Other bond counsel take the position that combining NMTCs with tax-exempt bonds is not limited to certain private activity bonds and can be used in connection with qualified 501(c)(3) bonds and traditional governmental non-private activity bonds. Such bond counsel base this conclusion on the fact that the proceeds of the bonds are ultimately used for a qualified bond project without creating impermissible private use from the bond loan to the investor. Those bond counsel look to the following:

(a) Treas. Reg. §1.141-3(a)(2) states that the ultimate use of the proceeds or the direct and indirect use of proceeds are what govern the qualification of the bond issue under Code Section 141/145;

(b) Treas. Reg. §1.141-3(d)(2) states that use by a nongovernmental person that is solely incidental to a financing arrangement is not private business use. The NMTC structure is essentially a financing arrangement;

(c) Prior IRS approval that loans to private lenders may not have impermissible private use derived from the loan of the proceeds to the lender where the lender is required to loan the proceeds to a qualified housing development (the so-called "loans-to-lenders" ruling). The enterprise zone facility bond regulations specifically permit the issuer to ignore the use by a lender in a loans-to-lender program; and

(d) Prior case law holdings that the substance, not the form, of the transaction governs the tax law analysis.

i. California Health Facilities Authority v. Commissioner 90 T.C. 832 (May 2, 1988); and

ii. General Counsel Memorandum 39455 (March 30, 1984).

In either case, it is essential to be able to trace the proceeds of the bonds through the structure to determine the ultimate use of the bond proceeds and conclude that the tax-exempt bond tests, including, in particular, use of proceeds and arbitrage, are satisfied.

4. Issues surround the security for the tax-exempt bonds because of the IRS requirement that the Leverage Loan be secured solely by the investor's equity interest in the CDE. The CDE is the entity that will have any security in the financed project as a result of the QLICI. In order to avoid the collapse of the NMTC structure, the leverage lender will be asked to "stand still" in exercising remedies for the NMTC Compliance Period in order to accommodate the need of the CDE to be able to reinvest QLICI proceeds during the 7-year NMTC Compliance Period in the event of a default and foreclosure. This requirement will significantly reduce the pool of potential lenders for transactions using the NMTC structure. In general, the lender or bond purchaser must be the same entity as the NMTC investor. This may raise issues for the counsel giving the NMTC opinion, because the same entity will then be receiving the benefit of both the credits and the tax-exempt interest. Another alternative may be for the leverage lender to make a separate loan directly to the QALICB that is not generating NMTCs and have rights under an intercreditor agreement with respect to direct remedies at least with respect to that separate loan.

5. NMTCs may be combined with other types of tax credits, including Historic Tax Credits under Section 47 of the Code, energy tax credits under Sections 46 and 48 of the Code and various state and federal grants. Each additional subsidy results in adjustment of the structure to accommodate the different rules.

III. HISTORIC TAX CREDITS

A. Overview. The Federal Historic Tax Credit ("HTC") program permits owners to receive a credit against Federal income taxes as an incentive to make expenditures to rehabilitate or preserve historic buildings. The credit is equal to 20% of qualified rehabilitation expenditures made to a "certified historic building" (certified by the National Park Service). Generally, the expenditures must be incurred in a 24-month period selected by the taxpayer (in accordance with the Treasury Regulations – generally exceeding the adjusted basis of the building) ending within the year the building is "placed in service." As a result of changes enacted by the Tax Cuts and Jobs Act of 2017, the HTC is taken over a five-year period generally beginning in the year in which the rehabilitated building is placed in service. Only the property owner who first places the building in service is entitled to the HTC. A party who begins rehabilitation can sell the property before completing the work and pass on the HTC provided that no one has already claimed the HTC and the building acquired has not been placed in service by the seller before the date of acquisition.

The HTC program is administered by the National Park Service ("NPS") and the IRS in partnership with State Historic Preservation Offices ("SHPO") in each state. The HTC is available to an owner of a "certified historic structure" or a lessee of such a structure with a lease term of at least 27½ years for residential rental property and 39 years for nonresidential real property.

In order to qualify for the HTC, a building must be a "certified historic structure" and must be rehabilitated in accordance with the Secretary of the Interior's standards for rehabilitation. There are four (4) factors needed to meet the basic application requirements for the HTC:

1. The historic building must be listed in the National Register of Historic Places or be certified as being of historic significance to a "registered historic district."

2. After rehabilitation, the historic building must be used for an income-producing purpose for at least five years. Owner-occupied residential properties do not qualify for the federal rehabilitation tax credit.

3. The project must meet the "substantial rehabilitation test." In brief, this means that the cost of rehabilitation must exceed the pre-rehabilitation cost of the building. Generally, this test must be met within two years or within five years for a project completed in multiple phases.

4. The rehabilitation work must be done according to the Secretary of the Interior's Standards for Rehabilitation. The rehabilitation standards include ten principles which, when followed, ensure the historic character of the building has been preserved in the rehabilitation.

B. Law. Section 47 of the Code (formerly section 48(g)), which became law on November 5, 1990 (Public Law 101-508; 26 U.S.C. 47). The related regulations are found at Treas. Reg. § 1.48-1 et seq.

C. **Key Definitions and Provisions**.

1. *Certified Historic Structure*. A certified historic structure is defined as a building (and is structural components) that is either listed in the National Register of Historic Places or located within a registered historic district and has been certified by the Department of the Interior as being of historic significance to the district. The National Register of Historic Places is maintained by the Department of the Interior under the National Historic Preservation Act. The cumulative list of properties in the National Register of Historic Places is published annually in the *Federal Register*. Buildings in historic districts must be "certified" or approved by NPS as contributing to the district as part of the "Historic Preservation Certification Application" (a three-part form application promulgated by the Department of the Interior).

A "registered historic district" is a district that is either:

(a) listed in the National Register, or

(b) both:

(i) designated under a state or local statute certified by the Secretary of the Interior as containing criteria that will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and

(ii) certified by the Secretary of the Interior as meeting substantially all of the requirements for the listing of Districts in the National Register. Department of Interior regulations set forth criteria for evaluating structures within "registered historic districts" to determine whether the structure should be certified as being "of historic significance to the district."

Only certified historic structures qualify for the credits. The "structure" must be a building.

The National Park Service must approve, or "certify," all rehabilitation projects seeking the HTC. A certified rehabilitation is a rehabilitation of a certified historic structure that is approved by the NPS as being consistent with the historic character of the property and, where applicable, the district in which it is located.

2. *Qualified Rehabilitated Building*. A "qualified rehabilitated building" is generally defined in Section 47(c)(1)(A) of the Code as any building (including its structural components) that has been "substantially rehabilitated," was placed in service before the beginning of the rehabilitation, and for which depreciation (or amortization) is allowable.

3. *Building*. The Code does not provide a definition of "building" for this purpose; however, Treasury Regulations issued under earlier Code provisions define "building" and distinguish between that term and other "structures" that are not "buildings" and, therefore, cannot qualify as "qualified rehabilitated buildings." Under Treas. Reg. § 1.48-1(e)(1), a "building" is "any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space." The term specifically includes apartment houses, factory and

office buildings, warehouses, barns, garages, railway or bus stations, and stores. Certain "structural components" of a building (i.e., parts of the building such as walls, floors and ceilings, and mechanical components) may be included, but the term "building" expressly does not include other "structures" such as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, coke ovens, and brick kilns.

4. *Substantially Rehabilitated.* A building is "substantially rehabilitated" only if the "qualified rehabilitation expenditures" during the 24-month period selected by the taxpayer exceed the greater of the adjusted basis of the building (and its structural components) or $5,000. The adjusted basis of the building is generally the purchase price, minus the cost of land, plus improvements already made, minus depreciation already taken. The basis is determined as of the beginning of the first day of the 24-month period, or of the holding period of the building, whichever is later. Once the substantial rehabilitation test is met, the credit may be claimed for all qualified expenditures incurred before the measuring period, during the measuring period and after the measuring period through the end of the taxable year that the building is placed in service.

5. *Qualified Rehabilitation Expenditure*. A "qualified rehabilitation expenditure" is any amount properly chargeable to a capital account in connection with the rehabilitation of a "qualified rehabilitated building" for which depreciation under Section 168 of the Code is allowed and which is (1) nonresidential real property, (2) residential rental property, (3) real property with a class life of more than 12.5 years, or (4) an addition or improvement to one of the previous types of property. Code § 47(c)(2)(A). The definition of "qualified rehabilitation expenditure" expressly excludes "the cost of acquiring any building or interest therein." Where the taxpayer acquires a building after another person has incurred "qualified rehabilitation expenditures," however, the regulations allow the taxpayer to be treated as having incurred the expenditures if the building was not used after the rehabilitation expenditures were incurred and no one other than the taxpayer is claiming the credit. Treas. Reg. § 1.48-12(c)(3)(ii). "Qualified rehabilitation expenditures" do not include "any expenditure attributable to the enlargement of an existing building." The Treasury Regulations provide that a building is "enlarged" to the extent that its total volume is increased. Where expenditures only partially qualify because some are used for enlarging the building, the expenditures must be specifically allocated between the original portion of the building and the enlargement to the extent possible. Treas. Reg. §§ 1.48-12(c)(7)(iii) and (c)(10). Section 280B of the Code disallows deductions for any amount expended for demolition of any structure and requires these costs to instead be treated as charged to the capital account for the land on which the demolished structure was located. Costs of demolition that result in complete removal of the building do not qualify for the rehabilitation credit. If the building still exists after some demolition, however, the costs of the demolition may qualify. Qualified rehabilitation expenditures typically do not include parking lots, sidewalks, landscaping or other related facilities.

6. *Certified Rehabilitation*. "Qualified rehabilitation expenditures" generally do not include expenditures for rehabilitating a "certified historic structure" unless the rehabilitation is a "certified rehabilitation." Code § 47(c)(2)(B)(iv). A "certified rehabilitation" is a rehabilitation of a "certified historic structure" that the Secretary of the Interior has certified to the Secretary of the Treasury as being "consistent with the historic character of such property or the district in which such property is located." Code § 47(c)(2)(C). The property owner must submit an Historic Preservation Certification Application to the National Park Service of the Department of the Interior in accordance with its regulations, and the National Park Service will determine whether

the rehabilitation meets the "Secretary of the Interior's Standards for Rehabilitation." The entire project is reviewed, including related demolition and new construction.

7. *Lessees*. Expenditures of a lessee of a building are not "qualified rehabilitation expenditures" if, on the date the rehabilitation is completed, the remaining term of the lease (not including any renewal periods) is less than the recovery period determined under Section 168(c) of the Code. Code § 47(c)(2)(B)(vi). This generally means that for nonresidential real property, the remaining term of the lease must be at least 39 years, and for residential rental property the remaining term must be at least 27½ years.

8. *Tax-Exempt Use Property*. A qualified rehabilitation associated with "tax-exempt use property" under Section 168(h) of the Code is not eligible for the HTC. This issue arises when a property owner leases its building or a portion of the building to a governmental unit, a tax-exempt organization or a foreign person/entity. Section 47(c)(2)(B)(v) of the Code excludes from the definition of "qualified rehabilitation expenditure" any expenditure allocable to any portion of the property that is or may reasonably be expected to be "tax-exempt use property" as defined in section 168(h) of the Code. The term "tax-exempt use property" includes that portion of the property leased to a tax-exempt entity in a "disqualified lease."

(a) *Disqualified Lease to Tax-exempt Entity*. The term disqualified lease means any lease of the property to a tax-exempt entity, but only if:

(i) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under Section 103(a) of the Code and the entity (or a related entity) participated in such financing,

(ii) under the lease there is a fixed or determinable price purchase or sale option which involves the entity (or a related entity) or there is the equivalent of such an option,

(iii) the lease has a lease term in excess of 20 years (including certain renewals), or

(iv) the lease occurs after a sale (or other transfer) of the property by, or lease of the property from, the entity (or a related entity) and the property has been used by the entity (or a related entity) before the sale (or other transfer) or lease.

(b) *50% Threshold Test*. If the portion of the property leased to tax-exempt entities in "disqualified leases" is no more than 50% of the property (based on net rentable floor space in the building), such portion of the property is not considered "tax-exempt use property." Code § 168(h)(1)(B)(iii) as modified by Code § 47(c)(2)(B)(v)(I). Although an expenditure allocable to "tax-exempt use property" is not a "qualified rehabilitation expenditure," and is, therefore, ineligible for the HTC, such expenditure may still be taken into account for purposes of determining whether a building has been "substantially rehabilitated." Treas. Reg. § 1.48-12(c)(7)(vi). If more than 50% of the building is leased to a tax-exempt entity, however, the HTC will not be allowed for that that portion of the building. For example, if a taxpayer spends $30,000 rehabilitating a building, and then leases 2/3 of it to a tax-exempt entity such that 2/3 of the building is tax-exempt use

property, the taxpayer may claim the rehabilitation credit only on $10,000 of the rehabilitation expenses.

(c) *Exception for Short-Term Leases*. Property is not considered "tax-exempt use property" merely by reason of a "short-term lease." A short-term lease means any lease the term of which is:

(i) less than three years, and

(ii) less than the greater of one year or 30% of the property's present class life.

(d) *Exception Where Property Used in an Unrelated Trade or Business*. The term tax-exempt use property does not include any portion of the property predominantly used by the tax-exempt entity (directly or through a partnership of which such entity is a partner) in an unrelated trade or business the income of which is subject to tax under Section 511 of the Code.

(e) *Property Leased to a Partnership*. When property is owned by a partnership that consists of both taxable and tax-exempt partners, Section 168(h)(5) of the Code provides a special rule for property which is leased to a partnership to prevent the use of tiered arrangements or partnerships or other pass-through entities. Under this rule, the determination of whether any portion of such property is tax-exempt use property is made by treating each tax-exempt entity partner's "proportionate share" of such property as being leased to such partner. A tax-exempt entity's proportionate share is determined on the basis of such entity's share of partnership items of income or gain (excluding gain allocated under section 704(c) of the Code), whichever results in the largest proportionate share. If a tax-exempt entity's share of partnership items of income or gain varies during the period such entity is a partner in the partnership, such share is the highest share such entity may receive. For purpose of this special rule, any tax-exempt controlled entity is treated as a tax-exempt entity unless the tax-exempt controlled entity makes a special election. A tax-exempt controlled entity is any corporation (which is not a tax-exempt entity) if 50% or more (in value) of the stock in such corporation is held by one or more tax-exempt entities. If the tax-exempt controlled entity makes the special election, any gain recognized by a tax-exempt entity on any disposition of an interest in the tax-exempt controlled entity (and any dividend or interest received or accrued by a tax-exempt entity from such tax-exempt controlled entity) will be treated as unrelated business taxable income for purposes of Section 511 of the Code.

(f) *Property Owned by a Partnership*. Section 168(h)(6) of the Code also provides a special rule for property owned by a partnership which has both a tax-exempt entity (or tax-exempt controlled entity) and a person who is not a tax-exempt entity as partners. Under this rule, the property can be treated as tax-exempt use property in certain circumstances even if the property is not leased to a tax-exempt entity. Specifically, if any allocation to a tax-exempt entity of partnership items is not a "qualified allocation," the tax-exempt entity's "proportionate share" of the partnership's property (except property predominately used by the tax-exempt entity in an unrelated trade or business the income of which is subject to tax under Section 511 of the Code) will be deemed to be tax-exempt use property.

(i) *Qualified Allocation*. A qualified allocation means any allocation to a tax-exempt entity which (i) is consistent with such entity's being allocated the same distributive share of each item of income, gain, loss, deduction, credit, and basis and such share remains the same during the entire period the entity is a partner in the partnership and (ii) has substantial economic effect within the meaning of Section 704(b)(2) of the Code.

(ii) *Proportionate Share*. A tax-exempt entity's proportionate share is determined on the basis of such entity's share of partnership items of income or gain (excluding gain allocated under Section 704(c) of the Code), whichever results in the largest proportionate share. If a tax-exempt entity's share of partnership items of income or gain varies during the period such entity is a partner in the partnership, such share is the highest share such entity may receive.

D. <u>Key Provisions for Financing Structure</u>.

1. *Pass-Through Election by Lessor*. Section 50(d) of the Code permits a lessor and lessee to agree to treat the lessee as having incurred all or a portion of the rehabilitation expenditures incurred by the lessor, provided the owner is not a tax-exempt entity. A tax-exempt entity cannot pass the HTC through because the Treasury Regulations require that the property be "section 38 property" in the hands of the lessor (that is, it must be property with respect to which depreciation is allowable to the lessor).

2. *Progress Expenditures*. If a building is being rehabilitated and the "normal rehabilitation period" for the building is two years or more, and it is "reasonable to expect" that the building will be a "qualified rehabilitated building" in the hands of the taxpayer when it is placed into service, Section 47(d) of the Code allows the taxpayer to irrevocably elect to use a special accounting method for the qualified rehabilitation expenditures. Rather than taking the credit in the taxable year the building is "placed into service," if the building is a "self-rehabilitated building," the taxpayer can take the qualified rehabilitation expenditures into account for the taxable year in which the expenditure is properly chargeable to capital account. If the building is not a "self-rehabilitated building," the expenditure is taken into account for the taxable year in which it was paid.

(a) *Normal Rehabilitation Period*. For the purposes of this provision, the "normal rehabilitation period" means the period reasonably expected to be required to rehabilitate the building from the time physical work begins and ending on the date the building is expected to be available to be placed in service.

(b) *Self-Rehabilitated Building*. A "self-rehabilitating building" is one for which it is reasonable to believe that more than half of the qualified rehabilitation expenditures will be made directly by the taxpayer.

3. *Effect of Credit on Basis*. Section 50(c) of the Code requires that the basis of the property must be reduced by the amount of the HTC. If the building is subject to the credit recapture provisions discussed immediately below, then the basis immediately before the event causing recapture (e.g., sale or other disposition) is increased by the recapture amount.

4. *Recapture of Credit*. If the rehabilitated building is disposed of or "otherwise ceases to be investment credit property with respect to the taxpayer" within five years after the building was placed in service, the HTC previously claimed is recaptured by increasing the taxpayer's tax by the amount of total HTC taken for rehabilitation expenditures, multiplied by a "recapture percentage" determined based on the holding period of the property. The recapture amount decreases by 20% for each year up to five years, so that if the property is disposed (or otherwise ceases to qualify) within one year after being placed in service, 100% of the HTC is recaptured; if during the second year, 80% is recaptured; if during the third year, 60% is recaptured, and so forth. Any carryback or carryover amounts also must be adjusted. Code § 50(a).

E. Combination with other Tax Credits/Tax-Exempt Bonds. HTCs can be combined with other types of tax credits and with tax-exempt bonds so long as the rules of both programs are met. However, the deal must be carefully structured to avoid the rules relating to "tax-exempt use" property. For example, HTCs can be combined with LIHTCs (Section 42 of the Code), NMTCs and with affordable housing tax-exempt bonds/tax credits under Section 42/142 of the Code (e.g. in an adaptive reuse scenario).

F. Historic Boardwalk Case. On August 27, 2012, the Third Circuit Court of Appeals issued an opinion in *Historic Boardwalk Hall, LLC, et al v. Commissioner*, 694 F.3d 425 (3rd Cir. 2012) in which the court held that a federal historic rehabilitation tax credit investor was not a bona fide partner in the limited liability company that owned the rehabilitated project as the investor "lacked a meaningful stake in the success or failure" of the company. The *Historic Boardwalk Hall* decision related to the redevelopment beginning in 1998 of Historic Boardwalk Hall, the historic home to the Miss America beauty pageant. Historic Boardwalk Hall was redeveloped by the New Jersey Sports and Exposition Authority, a state agency ("NJSEA"). In order to reduce the cost to NJSEA of the project, NJSEA solicited bids for federal rehabilitation tax credit investors. Pitney Bowes, Inc. ("PB") was chosen as the investor and, in an elaborately structured transaction, Historic Boardwalk Hall, LLC (the "Company") was formed; its managing member was as affiliate of NJSEA owning a 0.1% interest and its investor member was an affiliate of Pitney Bowes ("PB") having a 99.9% ownership interest.

The facts as described by the court focused on the structure of the transaction to isolate PB from any risks related to the Company's ownership and operation of the real estate. In this regard: (a) PB's capital contributions were scheduled to eliminate exposure to construction risk and NJSEA provided an uncapped completion guaranty to ensure construction completion of the project; (b) NJSEA provided PB with an uncapped environmental guaranty indemnifying PB from liability for losses from hazardous materials relating to the project; (c) NJSEA provided PB with a comprehensive tax benefits guaranty insulating PB from a failure to receive projected tax benefits; (d) the project was so laden with debt that it was unrealistic for PB to expect to receive any economic return other than the 3% preferred return to which it was entitled under the operating agreement of the Company; (e) one of NJSEA's purchase options for PB's interest, the price of which was tied to PB's 3% return, was fully funded pursuant to a guaranteed investment contract obtained by NJSEA; and (f) NJSEA provided PB with an uncapped operating deficit guaranty that in the court's view eliminated operational risk of the project. As the Third Circuit noted, NJSEA had the ability to fund all such guarantees as a result of its taxing authority.

In evaluating the totality of the factors as to whether PB's investor member was a partner in the venture, the Third Circuit found that the PB investor member had no meaningful stake in the success or failure of the enterprise (i.e. it did not have any meaningful downside risk or any

meaningful upside risk in the venture) and, therefore, was not a "bona fide partner" for federal income tax purposes. The Third Circuit found that NJSEA's extensive guarantees for construction completion risks, tax audit risks, environmental risks and operating deficit risks eliminated any downside risks of the venture to the PB investor member. Likewise the court concluded that there was no meaningful upside potential to the PB member in the Company because, while it technically had a 99.9% interest in any residual proceeds from the sale of the property, in reality, PB could never expect to share in any upside because NJSEA held a purchase option to acquire PB's interest after the tax credit recapture period, the purchase price of which was fully funded under the guaranteed investment contract obtained by NJSEA. The case caused quite a stir when decided and had effects beyond the HTC market.

G. <u>Revenue Procedure 2014-12 HTC Safe Harbors</u>. On December 30, 2013, the IRS issued Revenue Procedure 2014-12 (2014-3 IRB 1) (the "Revenue Procedure") establishing a safe harbor (the "Safe Harbor") under which allocations by partnerships to partners of historic tax credit projects will be respected and the status of investors as partners would not be challenged by the IRS in response to the disruption to the HTC market as a result of the Historic Boardwalk Hall case. As with all safe harbor guidance, not complying with all of the requirements of the Safe Harbor does not mean that an investor is not a partner or that an HTC transaction will not be respected under judicial and other applicable law. The Safe Harbor applies to transactions which only involve HTCs. Specific factors discussed in the Revenue Procedure include:

1. *Minimum Ownership Interest*. The general partner must have a minimum 1% interest in each material item of the partnership's income, gain, loss, deduction, and credit; and the investor must have a minimum interest in each material item of income, gain, loss, deduction, and credit during the period it owns an interest equal to 5% of its largest percentage interest for any taxable year (which presumably would be 99%, resulting in a 4.95% minimum interest).

2. *Bona Fide Investment*. The investor's interest must constitute a bona fide equity investment with a reasonable anticipated value commensurate with the investor's overall percentage interest in the partnership, separate from any federal, state, and local tax deductions, allowances, credits, and other tax attributes to be allocated by the partnership to the investor. The investment cannot be substantially protected from losses and the investor must participate in profits in a manner that is not limited to a preferred return that is in the nature of a payment for capital.

3. *Guarantees*. Certain guarantees listed in the Safe Harbor are impermissible (such as a guaranty of the investor's ability to claim historic credits, the cash equivalents of the credits, or the repayment of the investor's capital contribution due to its inability to claim the credits in the event the IRS challenges the transaction structure). Other guarantees are permissible if unfunded.

4. *Purchase and Sale Rights on Exit*. Neither the general partner, developer, owner, master tenant nor any person related to any of these may have a contractual right to purchase or redeem the investor's interest at a future date. This does not prohibit the parties from negotiating a present sale at some time in the future, as long as it was not pre-arranged. The investor may have a contractual right to require a person involved in the transaction to purchase or liquidate its interest in the owner or the master tenant at a future date for not more than fair market value as determined at the time of exercise. If an investor abandons its interest at any time, the investor will be presumed to have acquired its interest with the intent of later abandoning it unless the facts and circumstances clearly establish otherwise. Although superficially this provision would seem to

prohibit puts at a nominal price, it is only intended to prevent the investor from claiming an ordinary loss (as opposed to a capital loss) on exit, pursuant to Rev. Rul. 93-80, 1993-2 C.B. 239.

IV. ENERGY INVESTMENT TAX CREDITS

A. Overview. Taxpayers are permitted a 30% investment tax credit (the "Energy Credit") in the case of certain "energy property." Energy property that qualifies for the Energy Credit includes equipment placed in service after December 31, 2005 and before January 1, 2017 which uses solar energy (a) to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat (except property used to generate energy for the purposes of heating a swimming pool), or (b) to illuminate the inside of a structure using fiber-optic distributed sunlight. In addition, the energy property must be constructed, reconstructed or erected by the taxpayer or acquired by the taxpayer if the original use of the energy property commences with such taxpayer. Finally, depreciation or amortization must be allowable with respect to the energy property. The term "energy property" does not include (i) for periods before February 13, 2008, any property which is "public utility property" (as defined in Section 46(f)(5) of the Code as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), (ii) any property which is part of a facility that generated Code Section 45 tax credits for the taxable year or any prior taxable year, or (iii) any portion of the basis of any property which is attributable to qualified rehabilitation expenditures for purposes of the HTCs described above. Energy Credits are also not available for property to the extent that it is "tax-exempt use property."

B. **Law**. IRC §46 is the governing overall section for several credits, including the Energy Credit. The specific provisions for the Energy Credits are found in IRC §48.

C. **Key Terms for the Energy Credit**.

1. *Eligible Basis*. It is expected that the basis for determining the Energy Credit will be its cost, and would include all items properly includible by the taxpayer in the depreciable basis of the property, such as installation and freight costs under the rules of Treas. Reg. § 1.46-3(c)(1). The basis for determining the Energy Credit for costs attributable to periods prior to January 1, 2009, may be reduced proportionately to the extent the energy property is financed by "subsidized energy financing" or the proceeds of tax-exempt private activity bonds. No basis reduction is generally required for costs incurred on or after January 1, 2009.

2. *Timing of Energy Credit*. The Energy Credit can be claimed only in the year in which the energy property is "placed in service." Even where partners are admitted to a partnership after the partnership begins constructing or installing the energy property, Treas. Reg. § 1.46-3(f) provides that partners admitted to the partnership prior to the date on which the energy property is placed in service will be entitled to an allocation of their share of the Energy Credit with respect to that property.

3. *Reduction in Depreciable Basis*. If a taxpayer claims the Energy Credit with respect to energy property, the depreciable basis of the energy property must be reduced by one-half of the amount of the Energy Credit. This adjustment means that only 85% of the cost of the energy property can be deducted through cost recovery deductions and gain on disposition of the property is increased by one-half of the amount of the Energy Credit. Accordingly, the Energy

Credit results in part in a permanent reduction of tax liability, unless subject to recapture, and in part in a deferral of tax liability. Additionally, Eligible Basis for purposes of computing the HTCs must also be reduced by one-half of the amount of any Energy Credit.

D. Limitations on Energy Investment Tax Credits. The Energy Credit is a direct credit against a taxpayer's federal income tax liability and is subject to limitations on use by many investors as a result of at-risk rules and passive activity rules. The Code limits use of the Energy Credit and certain other tax credits to the amount of federal income tax liability that does not exceed $25,000 in such year plus 75% of any federal income tax liability in excess of $25,000. Any excess unused credits disallowed under this rule must be carried back 1 year and forward 20 years.

E. Recapture of the Energy Investment Tax Credit.

1. *Sale of Energy Property*. If energy property qualifying for the Energy Credit is sold or otherwise disposed of, assigned, retired, abandoned or converted to personal or non-business use prior to the expiration of five years from the date it was placed in service, all or a portion of the Energy Credit claimed will be recaptured. In such an event, a taxpayer's tax liability for the year in which such event occurs will be increased by an amount equal to the amount of the Energy Credit originally allowed multiplied by the "recapture percentage," which will vary depending on the date of disposition. The "recapture percentage" is 100% for a disposition within the first year after property is placed in service and decreases by 20% for dispositions within each of the next five years. The Energy Credit fully vests at the end of this 5-year recapture and is no longer subject to recapture.

2. *Reduction in Partnership Interest*. If a partner's interest in a partnership owning such energy property is reduced to less than two-thirds of its interest for the year in which the property was placed in service, whether by a transfer of all or part of its interest, the admission of new partners or a reduction in its share of profits, the partner will be required to recapture some or all of the Energy Credit claimed. Once recapture is required in a taxable year, additional recapture will not be required in subsequent years unless the partner's interest in the partnership is reduced to less than one-third of its interest at the time the property was placed in service. However, if the transfer of the partner's interest occurs because of a technical termination of a partnership under Section 708 of the Code, recapture will not be required if the termination meets the "mere change in form" exception in Treas. Reg. § 1.47-3(f) and Section 50(a)(4) of the Code.

V. <u>GREEN AND SOCIAL IMPACT BONDS</u>

Note: Neither Green Bonds nor Social Impact Bonds qualify for any specific federal tax credits or exemptions.

<u>Green Bonds</u>

(1) Designation that attracts investors from funds and other buyers targeting renewable energy, energy efficiency, carbon sequestration, clean transportation, etc.
(2) Is not limited to tax exempt bonds, but certain kinds of tax-exempt bonds qualify
(3) International Capital Market Association ("ICMA") has developed a set of "Green Bond Principles" (GBP) to be followed to certify that a bond qualifies for designation as a "green bond"
(4) Green Bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible green bond purposes and which are aligned with the four core components of the GBP. Those translate into various types of governmental and private activity bonds in the tax-exempt market.
(5) Green Purposes:
  (a) renewable energy (including production, transmission, appliances and products);
    (i) PACE programs
    (ii) Landfill gas energy production
  (b) energy efficiency (such as in new and refurbished buildings, energy storage, district heating, smart grids, appliances and products);
    (i) Guaranteed energy savings project financings
  (c) pollution prevention and control (including waste water treatment, reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy/emission-efficient waste to energy, value added products from waste and remanufacturing, and associated environmental monitoring);
    (i) Solid waste disposal bonds to finance waste to energy projects
    (ii) Governmental solid waste disposal and sewage treatment systems that meet GBP requirements
  (d) environmentally sustainable management of living natural resources and land use (including environmentally sustainable agriculture and animal husbandry)
    (i) Solid waste disposal bonds to finance hog/chicken/cattle waste to energy projects.
(6) Green Principles:
  (a) Use of Proceeds – project meets the criteria outlined above
  (b) Process for Project Evaluation and Selection
    Issuer clearly communicates to investors the environmental sustainability objectives; the process by which the issuer determines how the projects fit within the eligible Green Projects categories identified above; and the related eligibility criteria, including, if applicable, exclusion criteria or any other

process applied to identify and manage potentially material environmental and social risks associated with the Projects.

(c) Management of Proceeds

Green bond proceeds are tracked by the issuer in an appropriate manner and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for Green Projects.

(d) Reporting

Regular reporting on use of proceeds and their impact.

(7) A number of states and issuers have issued bonds that have been designated as "green bonds".
   (a) Central Puget Sound Regional Transit Authority sales Tax and Motor Vehicle Excise Tax Improvement Bonds Series 2015S-1, 2A, 2B (Green Bonds) and Series 2016S-1(Green Bonds) - expansion of the region's light rail system
   (b) DC Water Authority $350 million Public Utility Senior Lien Revenue Bonds, Series 2014A – DC clean rivers project; first green bond issuance to include an independent second-party opinion
   (c) Connecticut, Cleveland, Indiana, San Francisco Public Utilities Commission, and St. Paul, Minn. have also issued green water bonds
   (d) FNMA and FHLMC have "green designations" for projects meeting energy saving criteria
   (e) Several underwriters (JP Morgan, Goldman, among others) have green bond targets or funds

(8) Some statewide/local conduit issuers are considering the program, working with a third-party administrator, who for a fee, provides some or all of the services described, including vetting projects for inclusion in the program, evaluation and selection, oversight of use of proceeds and ongoing reporting as to the project and its compliance with the Green Bond principles

Social Impact Bonds

(1) Social Impact Bonds are any type of bond or debt instrument that will finance or refinance eligible social projects.
   (i) The ICMA notes that certain eligible social projects will also have overlapping environmental co-benefits.
   (ii) Social projects directly aim to address or mitigate a specific social issue and/or seek to achieve positive social outcomes especially but not exclusively for a target population.

(2) ICMA also has Social Bond Principles (SBP) to certify a bond as a "social bond"

(3) Eligible Social Projects
   (i) affordable basic infrastructure (clean drinking water, sewers, sanitation, transportation)
   (ii) access to essential services (e.g. health, education and vocational training, healthcare, financing and financial services)
   (iii) affordable housing
   (iv) employment generation, and programs designed to prevent and/or alleviate unemployment stemming from socioeconomic crises

(v) food security and sustainable food systems (such as physical, social, and economic access to safe, nutritious, and sufficient food that meets dietary needs and requirements

(vi) resilient agricultural practices; reduction of food loss and waste; and improved productivity of small scale producers)

(vii) socioeconomic advancement and empowerment (e.g. equitable access to and control over assets, services and resources, and opportunities; equitable participation and integration into the market and society, including reduction of income inequality)

(4) Target populations include, but are not limited to: (i) individuals and families living below the poverty line, (ii) excluded and/or marginalized populations and /or communities, (iii) people with disabilities, (iv) migrants and /or displaced persons, (v) undereducated persons, (vi) underserved, owing to a lack of quality access to essential goods and services (vii) unemployed individuals, (viii) women and/or sexual and gender minorities, (ix) aging populations and vulnerable youth, and (x) other vulnerable groups (for instance, as a result of natural disasters).

VI. PACE FINANCING

Property Assessed Clean Energy (PACE), which is currently available in 33 states, is a financing mechanism that enables low-cost, long-term funding for energy efficiency, renewable energy and water conservation projects. PACE financing is repaid as an assessment on the property's tax bill. PACE transactions are typically not tax-exempt obligations.

(1) Benefits of using PACE:

(a) Long-term fixed rate financing up to 20 years.

(b) Non-recourse.

(c) Finance 100% of eligible project costs.

(d) Can be combined with other debt and local, state, and federal incentive programs.

(e) Energy savings typically exceeds annual PACE assessment allowing for positive cash flow, improved net operating income, and enhanced property value.

(2) Here's the general process for using PACE financing to install solar panels on your property:

(a) A county, local, or municipal government passes legislation that establishes a PACE program and makes funds available to investors, usually through the sale of municipal bonds.

(b) An authorized PACE lender provides those funds to property owners who want to make clean energy improvements, like installing solar panels on their home or business.

(c) Property owners repay the financial institution through an assessment attached to their annual property tax bill.

VII. COMPARISON OF HISTORIC, NEW MARKETS AND ENERGY TAX CREDITS

	HTC	NMTC	ENERGY
Who receives the credit?	• Owner of the project • Lease pass- through structure –credits to master tenant	• Investor making the QEI in the CDE	• Owner of project • Lease pass-through structure – credits to master tenant
Is credit amount subject to volume limit?	• No	• Maximum dollar limit (currently $5 billion per year through 2025 • Competitive application to U.S. Treasury CDFI Fund	• No
What type of project/borrower qualifies?	• Building listed on National Register of Historic Places • Qualified Historic building originally placed in service before 1936 • Owner-occupied residential properties do not qualify • Project must be "substantial rehabilitation" (cost of rehab exceeds pre-rehab cost of building) • Not available for tax-exempt use property	• Borrower must be a QALICB • Project must be in qualified census tract or serve targeted population (employment, sales, services) • Certain "sin businesses" excluded • Governmental unit not a business • Can be used with "portion of a business • Rental of residential property not a QALICB	• Solar energy equipment (generate electricity, heat or cool structure, provide solar process heat • "Qualified facilities" including wind, closed-loop biomass, open-loop biomass, geothermal landfill gas, trash, hydropower, or marine, hydrokinetic • Energy credit eligibility subject to construction commencement dates varying with type of qualified facility • Not available for tax-exempt use property

	HTC	NMTC	ENERGY
How is the credit calculated?	• 20% of cost of the QRE for National Register property • 10% of costs of the QRE for qualified historic building • Entire credit taken in first year placed in service	• Aggregate of 39% of the QEI (5% for three years, 6% for 4 years • Calculated off the QEI, with requirement that 85% be used by the Sub-CDE for loan or equity investment in the QALICB	• 30% of capital cost of energy property (FMV) for investment tax credit (ITC) • Cents per kWh for production tax credit (PTC) • Phase down for wind facilities (PTC) and solar energy (ITC) • Portion of property receiving HTC not eligible • Tax-exempt financed costs eligible for credit
What is the compliance period/compliance burden	• 5 years from date project placed in service • Verification of qualified rehabilitation expenditures before eligible for credit by Department of Interior • QRE must be made within 2-year period (extended to 5 years if project completed in phases)	• 7 years • Transaction documents will require annual or semi-annual compliance certifications as to the QALICB status • CDE/Investor reporting to the CDFI Fund • Community Benefits Agreement in transaction documents (not required by Code)	• 5 years from date property is placed in service for ITC • 10 years for PTC

	HTC	NMTC	ENERGY
Does change in use, sale, casualty loss, foreclosure or other disposition of credit cause recapture?	• Recapture upon sale or disposition of property • Recapture on conversion of property to personal or non-income producing property • Recapture amount decreased by 20% each of 5 years (lose 100% of credits if dispose of in first year)	• Credits recaptured if (1) 85% of the QEI not invested in the QALICB, (2) the CDE fails to continue to be qualified the CDE, (3) the CDE repays the QLICI • Recapture of credits taken to date of event causing recapture, the CDE and the QALICB indemnify for the full credits taken plus value of expected credits to investor • Sale of the QEI to another investor does not cause recapture, so long as the original QEI is not redeemed. • Sale of the QALICB or project financed may not be a recapture if disposition proceeds reinvested within 1 year	• For ITC, recapture on sale or disposition, assignment, retirement, abandonment or conversion to personal or non-business use prior to end of 5 years after placed in service date • For ITC, recapture amount decreases by 20% each year • For ITC, only partners admitted prior to date property placed in service, or, for sale leasebacks, within 3 months

VIII. Low-Income Housing Tax Credits

A. Availability and Use

a. Available to owner of a residential rental project under IRC Section 42
    i. Competitively allocated or used with tax-exempt exempt facility bonds under IRC Section 142(d)
b. Typical owner is a limited partnership or limited liability company
c. Ownership structure is utilized so tax credits can flow through (allocated vs. certificated)
d. Amount of Credit
    i. Qualified Basis x Applicable Fraction x Applicable Percentage (i.e. 4% or 9%)
        1. Qualified Basis is eligible basis
            a. Generally, costs of residential rental property
            b. Common areas are included in basis
            c. Property funded with grants not included
            d. 130% basis boost applies for projects in qualified census tracts and difficult to develop areas
    ii. Applicable Fraction
        1. Competitive (9%) Credits fixed applicable percentage at 9% since 2008
        2. IRC 42(b)(3), enacted in 2020, "fixes" applicable percentage for "non-competitive" LIHTC at 4%
e. LIHTC is "collected" or "used" over 10-year period but compliance period is 15 years
    i. If minimum set-asides are not met or a change in ownership occurs during the 15-year period, recapture of the unearned portion of credit may occur.

B. Requirements

a. Qualifying Project- similar to IRC 142(d)
    i. 40-60, 20-50 unit set asides
        1. Income averaging also permitted
    ii. Must be residential rental property
    iii. Rent Restrictions
        1. Gross rent applicable to a unit cannot exceed 30% of the elected set-aside area median gross income.
            a. Gross rent does not include Section 8 payments or comparable rental assistance program payments.

C. Special Considerations for Existing Buildings

a. Anti-Churning
    i. Tax credit property cannot have been placed in service by the taxpayer or any related party to the taxpayer (*tested at time of placed in service*)
    ii. Related party status tested on capital interests and profits and losses.
b. 10-year hold

i. The building must have been placed in service at least 10 years prior to the date of acquisition by the new owner.
    1. Exceptions exist
        a. Placed in service by governmental entity or not-for-profit
        b. Building is substantially assisted, financed or operated under state or federal program.
            i. i.e., Section 8, HUD/GNMA, USDA