

New Tax Law Helps Affordable Housing and Community Development

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On December 18, 2015 President Obama signed the Consolidated Appropriations Act, 2016. Tucked within the 887 pages of the new law are 3 significant developments for the Affordable Housing and Community Development Industry. Below we summarize and give practice tips on (i) the permanent extension of the 9% Credit rate for the Low-Income Housing Tax Credit ("LIHTC"), (ii) the 5 year extension of the New Markets Tax Credit ("NMTC"), and (iii) the extension and expansion of Bonus Depreciation and how it can help current and future projects.

9% Minimum LIHTC Credit Rate Permanently Extended

At long last there is a permanent extension of the 9% rate for LIHTC projects that receive credit allocations. However, this does not mean the end of rate locks. Rate locks are still needed for allocated projects with acquisition credits or for any tax-exempt bond financed projects.

NMTC Extended Through 2019

Congress authorized \$3,500,000,000 of NMTC authority for each year through 2019. Annual allocations will thus not increase over those of recent years and not be indexed to inflation as we had hoped, but advocates for the credit rightfully prioritized achieving the longer-term extension over such considerations. In addition, although it is a 5-year extension, the first year of the extension is 2015. Thus the allocations only go through 2019. The CDFI Fund is now reviewing applications for the first of the 5 newly-authorized allocations and will announce awards in the summer.

Yield Improving Bonus Depreciation Extended Through 2019

Bonus Depreciation allows a project to expense 50% of certain new assets when they are placed in service. This can significantly accelerate the losses generated by a project. Increased losses result in a better yield for investors and can therefore allow for better equity pricing. However, Bonus Depreciation can be complicated. Below are some pointers in using it.

- ***Personal Property and Site Improvements Are the Primary Assets to Get Bonus Depreciation*** - Generally, Bonus Depreciation only applies to property that has a life of 20 years or less. For affordable housing and community development that will mostly mean Bonus Depreciation is limited to new personal property and site improvements. However, read the last section of this article for a discussion on the ability to use Bonus Depreciation on interior building costs for properties with substantial commercial components.
- ***Impact of Bonus Depreciation***- 50% of the cost of the asset would be

depreciated in the year placed in service with the remaining 50% depreciated as normal. For example, site improvements are normally depreciated on an accelerated basis over 15 years and get a 5% depreciation deduction in the first year. With Bonus Depreciation, 50% of the site improvements would be deducted in the first year with the remaining 50% using the regular 15-year schedule for a combined 52.5% deduction in the first year. Similarly personal property has a 5-year depreciation schedule with a 20% deduction in the first year. With 50% Bonus Depreciation, the combined first year deduction would increase to 60%.

- ***Good Things Don't Last Forever - Phasedown*** - The 50% Bonus Depreciation phases down over 5 years. The full 50% deduction is available for property placed in service before the end of 2017. The deduction is reduced to 40% for property placed in service in 2018 and 30% in 2019. Bonus Depreciation is not available for projects placed in service after 2019, except in the case of certain Long Production Property.
- ***Dedicated Improvements Are Good for Basis, But They Don't Get Bonus Depreciation*** - When a partnership pays to build property off-site and dedicates it to the government, if certain requirements are met it is possible to get such costs into eligible basis and depreciable basis. For example, building the roads next to the project and dedicating them to a city usually qualifies. However, under IRS rules such offsite improvements are deemed an indirect cost of the building. Dedicated improvements are not considered site improvements. As a result, such improvements do not qualify for Bonus Depreciation.
- ***Bonus Depreciation on Site Improvements Can Sometimes Create Capital Account Problems*** - LIHTC is allocated based on who is allocated depreciation. It is critical that a LIHTC investor's capital account stay positive for the 10-11 year credit delivery period. Taking Bonus Depreciation on a large amount of site improvements might cause an investor to run out of capital too early. In such cases it may be desirable to make an affirmative election not to take Bonus Depreciation. Because of the lesser amount of equity in a tax-exempt bond project, such projects are especially likely to run into capital account problems and need to elect out of Bonus Depreciation.
- ***Recent Projects Might Want to Avoid Bonus Depreciation*** - Projects that were scheduled to be placed in service in 2015 or later were likely underwritten without Bonus Depreciation. If those Projects had tight capital accounts (e.g., bond projects), they should be reviewed to make sure there are no potential problems. An election not to take Bonus Depreciation may be desirable.
- ***How to Elect Out of Bonus Depreciation on Site Improvements, But Keep It on Personal Property*** - Bonus Depreciation applies by default, unless an election is made on the tax return to not take it. The election is made for a specific class of property and would apply to all property of that class placed in service that year. Thus it is possible to keep Bonus Depreciation on personal property but elect not to take it on site improvements. Note that Bonus Depreciation on Personal Property is almost always good, even for projects with capital account problems.
- ***Caution with Cost Segregation Studies*** - In an effort to generate more Bonus Depreciation and a higher credit price, it might be tempting to get a cost segregation study from an accounting firm. Such studies scrutinize projects to identify assets that can be depreciated more quickly rather than being lumped into the slow depreciation building category. As a result, such studies could identify substantially more assets that qualify for Bonus Depreciation. However,

such studies have sometimes been aggressive and the IRS has audited projects with cost segregation studies. Because investors do not want a substantial portion of their yield to depend on whether or not a cost segregation study would prevail, a number of investors will not use cost segregation studies.

- ***Wait, I Can Get Bonus Depreciation on Improvements to a LIHTC Building? What about a Historic Tax Credit Commercial building?***- In general, Bonus Depreciation is not available for improvements that are capitalized as part of the building. However, in a new broadening of Bonus Depreciation, certain Qualified Improvement Property can qualify. Qualified Improvement Property is certain internal improvements to "Nonresidential Real Property" placed in service after December 31, 2015. For this purpose, Nonresidential Real Property is defined as property with less than 80% of gross rent from dwelling units. As a result, a building not used for housing could qualify. However, an apartment building (including a LIHTC building) can qualify if it has commercial rent that is more than 20% of all rent received from the building. The result is that some building costs that would normally be depreciated over 27.5 years or 39 years should instead be able to get an immediate 50% deduction for qualifying costs. In the right situation, this could be a significant enhancement to a project's yield and LIHTC credit pricing.
However, Congress did not open the spigot too far. Bonus Depreciation on Nonresidential Real Property is only for internal building costs and also does not apply to costs of building enlargements, elevators/escalators or internal structural framework. Thus qualifying expenses could include costs such as non-loadbearing walls, doors, flooring, plumbing, HVAC and other items that are determined to be non-structural framework.

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The availability of Bonus Depreciation for improvements to a building that qualifies for Historic Tax Credits ("HTCs") at first seem a good improvement. However, a technical requirement in order to qualify for HTCs is that the expense used to create the HTC must use straight-line depreciation. The one-year deduction for Bonus Depreciation conflicts with ban on accelerated depreciation. Thus for HTC Projects, one would make an election not to take Bonus Depreciation on Qualified Improvement Property. However, personal property and site work don't qualify for HTC and therefore even an HTC project can take the bonus depreciation on those assets.[\[1\]](#)

The permanent extension of the 9% Credit rate for LIHTC transactions, the extension of the NMTC, and the extension of Bonus Depreciation are significant improvements for the affordable housing and community development community.

For more information, please contact Glenn Graff (ggraff@att-law.com) or any member of the Tax Group, Lisa Pekkala, Ben Swartzendruber, Becca Hartstein or Eric Mittereder, at Applegate & Thorne-Thomsen.

[\[1\]](#) This article has been revised since its original publication on January 11, 2016 to clarify that HTC projects would want to elect not to take bonus depreciation on

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