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Impact of final Tax Reform Legislation on the Historic Tax Credit, New Markets Tax Credit, Low-Income Housing Tax Credit and Renewable Energy Tax Credits.

On Dec. 22, 2017, President Donald Trump signed into law "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" – widely referred to as the Tax Cuts and Jobs Act, or simply, the Tax Reform Legislation. As has been widely reported, the Tax Reform Legislation makes sweeping and extensive changes to federal tax law on a scale not seen since 1986. Here, we will focus on the impact of the Tax Reform Legislation on certain federal project-based income tax credits, including the Low-Income Housing Tax Credit (LIHTC), the New Markets Tax Credit (NMTC), the Historic Tax Credit (HTC), and the Production Tax Credit (PTC) and Investment Tax Credit (ITC) for renewable energy projects.

Unlike the tax reform bill passed by the House of Representatives, which would have significantly altered many of these project-based tax credits, the final Tax Reform Legislation generally leaves the credits in place, although with some modifications.

The HTC endured the most adjustment under the Tax Reform Legislation. Prior to the enactment of that legislation, the HTC provided a taxpayer who rehabilitated a historic structure with a tax credit equal to 20% of the taxpayer's "qualified rehabilitation expenditures" if the structure was listed on the National Register or was otherwise certified by the Secretary of the Interior as being historically significant, or 10% of the taxpayer's qualified rehabilitation expenditures if the structure did not meet those criteria but was originally placed in service prior to 1936; the tax credit was claimed in its entirety in the year the building was placed in service, subject to a five-year recapture period. The newly revised law eliminates the 10% credit for pre-1936 buildings not listed on the National Register or otherwise certified by the Secretary of the Interior and restructures the 20% credit so that it is claimed ratably over a five-year period beginning in the year the building is placed in service. (A transition rule allows taxpayers who own historic buildings as of Dec. 31, 2017, to take advantage of the pre-amendment version of the HTC for a period of time.)

While the other project-based tax credits were left in place unchanged, the shift, under the Tax Reform Legislation, in how multi-national corporations are taxed will likely impact their relative value. These credits are rarely of value to the developers of the projects to which they apply, as those developers typically do not have sufficient tax liability to fully utilize the credits. Instead, developers will typically shift the benefit of these tax credits to investors, in exchange for cash infusions into the underlying projects. Historically, these investors have been banks and other large corporations with significant tax liability; in many cases, these investors have significant overseas operations. One of the more significant changes the Tax Reform Legislation makes to the taxation of corporations is the imposition of a Base Erosion and Anti-Abuse Tax (BEAT), which is designed to counteract efforts by multi-national corporations to shift income from the United States to lower-tax jurisdictions. In calculating their BEAT liability, corporations may claim none of their HTCs and NMTCs, and only 80% of their LIHTCs and PTCs and ITCs for renewable energy projects, reducing the value of those credits to those corporations and presumably reducing the amount investors will be willing to contribute to projects in exchange for them (either due to investors' BEAT liability, or due to the decreased demand for the credits among investors). Moreover, beginning in 2026, LIHTCs and PTCs and ITCs for renewable energy projects will be treated like HTCs and NMTCs, and corporations will not be able to use any portion of these credits against their BEAT liability, effectively eliminating the value of those credits to investors subject to the BEAT.

Similarly, the change to the HTC – which is also generally shifted from developers of historic projects to investors in them – from a credit claimed all at once to a credit claimed ratably over five years will likely reduce the value of that credit to investors and/or impact the timing of investors' cash infusions into the underlying projects, potentially amplifying the need for bridge financing and increasing developers' borrowing costs.

Further, the reduction, under the Tax Reform Legislation, in the top corporate tax rate from 35% to 21% will reduce the value of depreciation deductions that are sometimes allocated to investors in low-income, historic and renewable energy projects, further reducing the tax benefits available to investors in those projects and likely further reducing the amount that investors are willing to deploy into those projects in exchange for those tax benefits.

While the actual impact of the Tax Reform Legislation on the market for these project-based tax credits will only become clear over time, it is safe to assume that the Tax Reform Legislation will negatively impact the sources of funds available to developers of low-income housing, historic rehabilitation and renewable energy projects, and projects located in disadvantaged areas eligible for the NMTC.

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