CPAs & Business Advisors

17501 East 17th Street, Suite 100 ● Tustin, California 92780-7924
(714) 505-9000 ● Fax (714) 505-9200 ● www.hmwccpa.com ● cpas@hmwccpa.com

Member:
American Institute of Certified Public Accountants
Alliance of Merger & Acquisition Advisors
AHA Affiliated Healthcare Advisors

Need financing for a new project?

Let tax credits come to the rescue

When launching a new project, it might be difficult to secure financing from lenders if you have high loan-to-value ratios. But on the right project, certain tax credits may generate the equity you need to bridge the gap. Here's a look at some valuable credits that can help you do just that.

Housing projects

Affordable-housing projects may be more attractive to developers in today's environment, and low-income housing tax credits (LIHTCs) are part of the appeal. Under Internal Revenue Code (IRC) Section 42, the federal government gives state housing finance agencies the authority to issue LIHTCs to developers for the acquisition, rehabilitation or new construction of rental housing for lower-income residents.

To qualify for the credits, a developer must:

- Rent at least 40% of the units to tenants with incomes equal to or less than 60% of the area's median income, *or*

- Rent at least 20% of the units to tenants with incomes equal to or less than 50% of the area's median income.

The minimum required units must remain at the respective rental level for at least 30 years, and rent can be no more than 30% of the tenant's maximum eligible income as determined by HUD. Developers can otherwise design and manage the project as desired.

The credits equal about 9% of the qualified basis (that is, the amount of depreciable development costs that can be included in the calculation of the credits) per year for 10 years on new construction or rehabilitation projects that aren't financed with tax-exempt bonds. The credits are generally about 4% for new construction or rehabilitation projects that are federally subsidized and for acquisition of eligible existing buildings.

Rehabilitated properties

Historical properties may be eligible for rehabilitation tax credits under IRC Sec. 47. The credits apply to costs incurred for the rehabilitation of qualified buildings. "Rehabilitation" encompasses renovation, restoration and reconstruction; it doesn't include enlargement or new construction.

The credits generally equal 20% of qualified rehabilitation expenditures (QREs) for certified historic structures and 10% for nonhistoric, nonresidential buildings placed in service before 1936. QREs include the costs of work on the building, architectural and engineering fees, survey fees, and other construction-related costs added to the property basis that are reasonable and related to the services performed.

The rehabilitation must be substantial, meaning the QREs during a 24-month period (or, for a phased project, a 60-month period) exceed the adjusted basis of the building or $5,000, whichever is greater.

17501 East 17th Street, Suite 100 • Tustin, California 92780-7924
(714) 505-9000 • Fax (714) 505-9200 • www.hmwccpa.com • cpas@hmwccpa.com

Member:
American Institute of Certified Public Accountants
Alliance of Merger & Acquisition Advisors
AHA Affiliated Healthcare Advisors

Global Representation:

New markets

The new markets tax credit (NMTC) program grants investors a credit on qualified equity investments in certified development entities (CDEs). The credit is claimed over a seven-year period at a rate of 5% of the qualified investment in each of the first three years and 6% in each of the last four years.

The CDE must make a qualified low-income community investment in the form of equity or a loan to a qualified active low-income community business (QALICB) within a year from when an investor makes the investment in the CDE. Most commercial and mixed-use development projects in low-income census tracts qualify as QALICBs.

Older buildings that qualify for such credits are often located in NMTC-qualified census tracts. Unlike rehabilitation tax credits, though, the annual dollar volume of NMTCs allocated by the federal government is capped, making the application process highly competitive.

From credits to equity

To generate equity for a project, a developer can form a limited partnership or limited liability company (LLC) with an investor. As an owner of the project, the investor can claim any applicable tax credits against its federal income tax liability.

According to the CCIM Institute, the investor must receive 99% or more of the profits from the project to maximize the allocation of the credits and the investor’s equity contribution. The developer, however, can structure the project so it receives reasonable development and project management fees upfront, before sharing net profits with investors.

All of these tax credits are subject to recapture if certain requirements aren’t satisfied. Once the credits vest, investors typically use a put option to transfer their interests in the project to the developer for a percentage of the equity they invested. If investors don’t exercise their put options, most contracts allow developers to exercise a call option at fair market value.

Covering all your bases

Harnessing the power of tax credits can make the difference between a well-funded project and one that’s just limping along. Beyond the tax credits mentioned here, be sure to check out all the federal and state tax credits available in your area. And involve your attorney and tax advisor to ensure you comply with all the rules.

CPAs & Business Advisors

17501 East 17th Street, Suite 100 ● Tustin, California 92780-7924
(714) 505-9000 ● Fax (714) 505-9200 ● www.hmwccpa.com ● cpas@hmwccpa.com

Member:
American Institute of Certified Public Accountants
Alliance of Merger & Acquisition Advisors
AHA Affiliated Healthcare Advisors

Global Representation:

Sidebar: Trade tax credits for government cash

The American Recovery and Reinvestment Act of 2009 (ARRA) created a new energy grant program under which the Treasury Department makes payments for “specified energy property” in lieu of tax credits for renewable electricity production and solar energy. ARRA Section 1603 credits, and thus the payments, range from 10% to 30% of the property’s basis, depending on the type of property.

The application deadline has passed for property placed in service in 2009 or 2010, but applications for property on which construction *began* in either of those years can be submitted until Oct. 1, 2011. To qualify for the ARRA energy grant program, construction must begin before Dec. 31, 2010.

A safe harbor in the Treasury Department guidelines defines the beginning of construction as the point at which the taxpayer has incurred or paid at least 5% of the total cost of the property, excluding land and certain preliminary planning activities. The property must be placed in service before the applicable “credit termination date,” which could be as far out as Jan. 1, 2017, for some types of specified energy property.

Specified energy property includes *only* tangible property, such as geothermal heat pumps or solar panels, that is an integral part of a facility.