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Community Development and Affordable Housing ALERT

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Impact of the American Recovery and Reinvestment Tax Act

On February 17, 2009 (the Effective Date) President Barack Obama signed into law the American Recovery and Reinvestment Act of 2009 (Stimulus Act) including the American Recovery and Reinvestment Tax Act of 2009 (Tax Act). The Stimulus Act and Tax Act include a number of tax credit and tax exempt bond provisions that affect affordable housing and community development programs. Below is a general summary of several of these provisions.

Low-Income Housing Tax Credit (LIHTC) Program

- **Grants in Lieu of LIHTC Allocations.** Section 1602 of the Tax Act provides that a state housing credit agency (State Agency) may elect to receive grant funds in lieu of LIHTC allocations for 2009 in an amount that does not exceed 85 percent of the product of (i) the sum of (A) 100 percent of the unused LIHTC allocation for 2008 and the LIHTC allocation returned in 2009, plus (B) 40 percent of the 2009 LIHTC allocation and the unused LIHTC carryover allocated to the state in 2009, multiplied by (ii) 10. The grants awarded under Section 1602 of the Tax Act shall be allocated by State Agencies as loans or grants to finance construction, acquisition and rehabilitation of qualified low-income buildings in the same manner and subject to the same limitations as an LIHTC allocation.

  The allocations may be made to projects with or without an LIHTC allocation; provided that if an award is made to finance a building without an LIHTC allocation, the State Agency must determine that the use of such funds will increase the total funds available to the state to build and rehabilitate affordable housing. Applicants that are allocated LIHTC must demonstrate good-faith efforts to obtain investment commitment for such credits before the State Agency funds under Section 1602. Each State Agency is required to perform asset management services with respect to each award

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made under Section 1602 of the Tax Act to ensure that the funds are used comply with LIHTC statutes and regulations, and shall impose recapture requirements in the event that the building for which the funds are awarded does not remain a qualified low-income building.

The Internal Revenue Service (IRS) will need to provide additional guidance on how the State Agencies will be required to implement these provisions including information regarding the timing of the federal government's distribution of funds to the State Agencies. In addition, each State Agency will need to update its qualified allocation plan to put in place priorities for the allocation and reallocation of grant funds to projects and to clarify timing of availability of funds to projects, as well as administrative and asset management costs and procedures that will apply to projects receiving the state grant funds.

- **Reduction in LIHTC Allocations.** Section 1404 of the Tax Act provides that a state's housing credit ceiling for 2009 will be reduced by the amount of the grants received by such state pursuant to Section 1602 of the Tax Act (described above). In addition, Section 1404 provides that such grant funds will not be federal grants that would reduce the eligible basis of a qualified low-income building. It is important to note, however, that, although the legislative history suggests that the grants should not be taxable, the Tax Act does not provide that the grants will be nontaxable to the recipient.

- **Additional HOME Funds.** The Stimulus Act provides that US$2.25 billion of additional HOME funds will be available until September 30, 2011 to State Agencies in the percentages of HOME funds apportioned to each state for fiscal year 2008 for investment in LIHTC projects. HOME funds available under the Stimulus Act must be awarded by State Agencies pursuant to such state's qualified allocation plan to projects awarded LIHTCs in fiscal years 2007, 2008 or 2009. Priority will be given to projects that are expected to be completed within three years of the Effective Date. Seventy-five percent of the HOME funds available to a State Agency under the Stimulus Act must be committed by that State Agency within one year of the Effective Date. A recipient of funds must expend 75 percent of the funds allocated to it within two years of the Effective Date and must expend 100 percent of the funds within three years of the Effective Date. Failure of a recipient to expend funds as required will result in the funds being redistributed in the state; any funds not expended within three years after the Effective Date shall be redistributed to other states that have used all funds distributed to them. HOME funds awarded under the Stimulus Act shall be allocated by State Agencies as loans or grants in the same manner and subject to the same limitations as an LIHTC allocation. Each State Agency is required to perform asset management services with respect to each award of HOME funds made under the Stimulus Act to ensure that the funds are used in compliance with LIHTC statutes and regulations. Any grant of HOME funds permitted under the Stimulus Act shall not reduce the eligible basis of a qualified low-income building. The additional HOME funds appear to be subject to all HOME requirements including environmental review and wage determination requirements.

New Markets Tax Credit (NMTC) Program

- **Increased Allocation Limit.** Section 1403 of the Tax Act amends Section 45D(f)(1) of the Internal Revenue Code of 1986, as amended (Code) to provide for an increase of US$1.5 billion in the annual maximum amount of NMTC allocated for each of 2008 and 2009, thereby increasing the total allocation for each such year from US$3.5 billion to US$5 billion. The additional amount for 2008 must be allocated to qualified Community Development Entities that submitted an allocation application for 2008 and either (i) did not receive an allocation for 2008 or (ii) received an allocation for 2008 in an amount less than requested.

Energy Tax Credit Programs

- **Extension of Renewable Electricity Production Tax Credit (PTC).** Section 1101 of the Tax Act extends the placed-in-service dates for the PTC through December 31, 2012 for wind facilities and through December 31, 2013 for closed-loop biomass facilities, open-loop biomass facilities, geothermal facilities, landfill gas facilities, trash facilities, qualified hydroelectric facilities, and marine and hydrokinetic renewable energy facilities. In addition, Section 1101 repeals the PTC for small irrigation power facilities as of October 3, 2008. No changes were made to placed-in-service dates for refined coal production facilities or Indian coal production facilities that were required to be placed in service by December 31, 2008 in order to be eligible for the PTC, or for solar energy facilities that were required to be placed in service before January 1, 2006 to be eligible for the PTC.

- **Energy Credit in Lieu of Renewable Electricity Production Tax Credit.** Pursuant to Section 1102 of the Tax Act, tangible personal property and other tangible property (not including buildings or structural components thereof) with respect to which depreciation (or amortization in lieu of depreciation) is allowable if such property is used as an integral part of a facility that is eligible for certain PTCs (i.e., those facilities listed in the foregoing paragraph) and placed in service as provided in the foregoing paragraph may, at the taxpayer's irrevocable election, receive a 30-percent energy investment tax credit described in Code Section 48 rather than the PTC.

- **Repeal of Wind Energy Facility Limitation.** Section 1103(a) of the Tax Act repeals the US$4,000 limitation under Code Section 48(c)(4) on the energy credit for qualified small wind energy property.

- **Repeal of Reductions in Eligible Basis.** In addition, Section 1103(b) of the Tax Act repeals the reduction of eligible basis for the energy credit in Code Section 48 with respect to private activity bonds and subsidized energy financing for periods after December 31, 2008. The reduction of eligible basis is also eliminated with respect to the nonbusiness energy credit and the residential energy credit and advanced coal projects and coal gasification projects.

- **Extension of Nonbusiness Energy Credit and Residential Energy Credit.** Sections 1121 and 1122 of the Tax Act extend the credits for nonbusiness energy property and the residential energy property. In addition, the amount of credits is modified to provide that for individuals, the amount of credit shall be 30 percent of (i) the amount paid or incurred for quality energy-efficient improvements plus (ii) the amount of the residential energy property expenditures paid or incurred by the taxpayer, provided that the aggregate amount of credits allowable in 2009 and 2010 for any taxpayer is US$1,500.

- **Credit for Qualifying Advanced Energy Projects.** Section 1302 of the Tax Act creates a new energy credit for investment in "qualifying advanced energy projects." A "qualifying advanced energy project" is described as a project to re-equip, expand or establish manufacturing facilities to make components of other energy property. The amount of credits for which a taxpayer may be eligible is 30 percent of the qualified investment for the year, and the total amount of all credits available under the program is limited to US$2.3 billion. Section 1302 provides that the Secretary of the Treasury must establish the program with 180 days after the Effective Date and that applications must be taken within two years of the establishment of the program. Once an application is accepted, the applicant has one year to meet the certification criteria established by the Treasury Secretary. After the certification is made, the applicant must place the project in service within three years. Section 1302 prescribes that the Treasury Secretary consider for certification only projects that are reasonably expected to be commercially viable, and shall take into consideration projects that:

  i. Provide the greatest domestic job creation during the credit period;

  ii. Provide the greatest impact in avoiding or reducing air pollutants;

iii. Have the greatest potential for technological innovation and commercial deployment;

iv. Have the lowest cost of energy or reduction in energy consumption or greenhouse gas emission; and

v. Have the shortest time from certification to completion.

- **Grants in Lieu of Energy Credit.** Section 1603 of the Tax Act provides that a taxpayer may obtain a cash grant equal to the energy credit otherwise available for certain energy property placed in service in 2009 or 2010, or after 2010 and before the credit termination date, as long as construction is commenced in 2009 or 2010. The amount of the credit is equal to (i) 30 percent of the qualifying costs for wind facilities, closed-loop biomass facilities, open-loop biomass facilities, geothermal facilities, landfill gas facilities, trash facilities, qualified hydroelectric facilities, marine and hydrokinetic renewable energy facilities, qualified fuel cell property, solar energy property and qualified small wind energy property, and (ii) 10 percent of qualifying costs for certain other qualifying property. Section 1104 of the Tax Act provides that no PTC or energy credits shall be claimed under Code Sections 48 or 45 with respect to property for a taxable year in which funds under Section 1603 of the Tax Act are received or any subsequent taxable year. In the event that the credits were claimed prior to a recipient receiving funds pursuant to Section 1603 of the Tax Act, those credits will be recaptured. The grants under Section 1603 will not be included in the gross income of the taxpayer, but will be taken into account in determining the basis of the property, except that the basis shall be reduced in the same manner as a credit.

Bond Provisions

- **Expansion of Qualified Tax Exempt Obligation.** Section 1502 of the Tax Act increases the qualified tax exempt obligation limit from US$10 million to US$30 million for tax exempt bonds issued in 2009 and 2010 (new bonds or refunding bonds). In applying the US$30 million limit to qualified 501(c)(3) bonds issued during 2009 and 2010, the bonds are treated as though issued by the 501(c)(3) borrower and not by the actual issuer. Thus, each 501(c)(3) borrower is subject to its own US$30 million limitation and qualified 501(c)(3) bonds do not count against the issuer's limit. For pooled financings, the limit is applied to the "qualified borrower" (from the pool) rather than to the pool issuer.

- **Safe Harbor to Investment Interest of Financial Institutions.** Financial institutions are generally not allowed to deduct the portion of their interest expense that is allocable to tax exempt interest received on bonds that are not qualified tax exempt obligations. The allocation is generally made by multiplying the bank's interest expense by the ratio of tax exempt bonds (other than qualified tax exempt obligations) to total assets of the bank. Section 1501 of the Tax Act permits a financial institution to exclude from the numerator of that fraction tax exempt obligations owned by the financial institution issued during 2009 and 2010, up to a limit of 2 percent of the financial institution's assets. However, tax exempt obligations excluded from the numerator under the above are treated as "financial institution preference items," and any interest deduction attributable to them is reduced by 20 percent in the case of financial institutions that are banks. Current or advance refunding bonds are treated as having been issued on the date of the original refunded bond.

Other Provisions

- **Extension of Bonus Depreciation.** The Economic Stimulus Act of 2008 permitted taxpayers to claim 50 percent of the basis of "qualified property," including most assets with a recovery period of 20 years or less, as "bonus depreciation" in the year the asset is placed in service. Taxpayers may then claim the regular depreciation amount on the remaining 50 percent of the asset's basis. The Economic Stimulus Act of 2008 applied to assets placed in service in 2008. Section 1201 of the Tax Act amends Code Section 168(k) to extend a taxpayer's ability to claim bonus depreciation to qualified property placed in service during 2009.

- **Limitations on Built-In Losses.** The IRS previously issued IRS Notice 2008-83, which allows banking institutions that have acquired other banking institutions to offset income by the built-in losses of the acquired bank. Section 1261 of the Tax Act determines that IRS Notice 2008-83 is inconsistent with Code Section 382(m). Consequently, Section 1261 provides that built-in losses may be taken in connection with bank acquisitions that occurred (i) on or before January 16, 2009 or (ii) after January 16, 2009, only if the acquisition is pursuant to (A) a written binding contract entered into on or before that date or (B) a written agreement entered into on or before that date and which was described in a public announcement or in a filing with the Securities and Exchange Commission.

  Section 1262 of the Tax Act provides that the limitations set forth in Code Section 382(b) relating to losses following a change in ownership shall not apply in the case of an ownership change pursuant to a restructuring plan that is (i) required by a loan agreement or a commitment for a line of credit pursuant to the Emergency Economic Stabilization

Act of 2008 and (ii) intended to result in rationalization of the costs, capitalization and capacity with respect to the manufacturing work force of, and suppliers to, the taxpayer and its subsidiaries. The relief does not apply (i) to ownership changes subsequent to the change occurring as a result of the Emergency Economic Stabilization Act of 2008 or (ii) if the ownership change results in any person owning 50 percent or more of the total combined voting power of the corporation or 50 percent of the total value of the stock of the corporation. Related persons (as defined within the Tax Act) will be treated as a single person in this context.

- **Cancellation of Debt Income.** Code Section 108 is amended by the Section 1231 of Tax Act to provide that for 2009 and 2010, at the election of the taxpayer, cancellation of debt income arising from the reacquisition of debt will be includible over a five-year period. The five-year period will be deferred until: (i) for debt reacquired in 2009, the fifth taxable year following the taxable year in which the reacquisition occurs and (ii) for debt reacquired in 2010, the fourth taxable year following the taxable year in which the reacquisition occurs. Special rules apply to partnerships.

- **Additional Community Development Block Grant Funds.** Title XII of the Stimulus Act provides that US$1 billion shall be available until September 30, 2010 for the community development block grant program under Title 1 of the Housing Community Development Act of 1974, provided that the recipients of the funds are grantees that received funding in 2008, and that priority shall be given to projects that can award contracts based on bids within 120 days from the date the funds are made available to the recipients.

- **Project-Based Rental Assistance.** The Stimulus Act provides that US$2 billion shall be used for assisted housing project-based rental assistance, of which US$250 million shall be used for assisted housing energy retrofits. Such funds shall be administered by the Office of Affordable Housing Preservation of HUD. Owners awarded funds for assisted housing project-based rental assistance will be required to commit to an additional period of affordability of not less than 15 years.

If you have questions on these provisions or would like to learn more, please contact your principal Squire Sanders lawyer or one of those listed in this Alert.

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