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Tax Credit Provisions in President Obama's FY 2014 Budget Proposal

On Wednesday, April 10, 2013, President Obama released his Administration's proposed budget for federal fiscal year 2014. Among the included proposals are various changes to the New Markets Tax Credit and Low-Income Housing Tax Credit programs, as well as the introduction of a new proposed Manufacturing Communities Tax Credit.

Expand and Modify the New Markets Tax Credit (NMTC)

The Administration's proposed budget would provide for the permanent extension of the NMTC with an annual $5 billion allocation. The NMTC program would be expanded by allowing NMTCs generated from qualified equity investments made after December 31, 2012 to offset alternative minimum tax liability, which the NMTC industry has been seeking. In addition, the Administration estimates that $250 million of each annual round would support the financing of healthy food options in distressed communities as part of the Healthy Food Financing Initiative.

Proposed Manufacturing Communities Tax Credit (MCTC)

The Administration proposes a new targeted tax credit to support investments in communities that have suffered a major job loss event, such as the closure or substantial reduction by a major employer of a large facility or operating unit or the closure of a military base. Applicants would be required to consult with relevant state or local Economic Development Agencies (or similar entities) in selecting investments that would qualify for the credit. The MCTC could be structured using mechanisms similar to those of the NMTC or as an allocated investment credit similar to the Qualifying Advanced Energy Project Credit. The proposal would provide $2 billion in credits for qualified investments approved in each year from 2014 through 2016.

Low-Income Housing Tax Credit (LIHTC)

Permit States to Convert Private Activity Bond Volume Cap Into LIHTC Allocations

States would be authorized to convert private activity bond volume cap to be received in a given calendar year into allocable LIHTC for the same year, subject to an annual maximum conversion amount equal to 7% of a state's volume cap for that year. The conversion ratio would be reset each calendar year to respond to changing interest rates. For each $1,000 of volume cap converted, the state would receive allocable LIHTC equal to $1,000 multiplied by twice the applicable percentage for 30% present value LIHTCs as of December of the preceding calendar year.

Encourage Mixed Income Occupancy by Permitting LIHTC-Supported Projects to Elect a Criterion Employing a Restriction on Average Income

In order for a building to qualify for LIHTC, the taxpayer must make an irrevocable election between either (1) at least 20% of the units must be rent restricted and occupied by tenants with income at or below 50% of area median income (AMI) or (2) at least 40% of the units must be rent restricted and occupied by tenants with incomes at or below 60% of AMI. The proposal would introduce a third option where at least 40% of the units must be occupied by tenants with incomes that *average* no more than 60% of AMI. Under this third option, no rent-restricted unit in the project could be

occupied by a tenant with income over 80% of AMI, and tenants with incomes below 20% AMI would treated as having incomes equal to 20% AMI.

Rehabilitation projects receiving ongoing rental or operating subsidies, such as Section 8, would be subject to a special rule where, if a tenant had an income of 60% or less of AMI at the time the tenant became a resident of the project, and the tenant's income later increases to more than 60% but not more than 80% of the AMI applicable at the time the tenant's income is measured for LIHTC qualification (referred to as the "Credit-Year-1 AMI Percentage"), the taxpayer may elect to allow the tenant to remain as a resident without impairing the LIHTC. Such an election would result in:

- the average-income criterion being applied without taking that tenant's unit into account;
- the requirement in the next-available-unit rule would apply (see section 42(g)(2)(D)(ii)); and
- the tenant's unit would be treated as rent restricted if the gross rent collected from the unit does not exceed 30% of the Credit-Year-1 AMI Percentage multiplied by current AMI.

Change Formula for 70% Present Value and 30% Present Value LIHTCs

The proposal would permit the temporary 9% minimum applicable percentage to expire at the end of 2013 and would increase the discount rate used in the present value calculation for allocated LIHTCs. The new discount rate would be the average of the mid-term and long-term applicable Federal rates for the relevant month, plus 200 basis points. The new discount rates apply to both 70% new construction/rehabilitation and 30% acquisition allocated LIHTCs, but would not apply to the 30% present value credit rate for LIHTCs that result from bond financing which would continue to be computed under current law. The change in discount rate is intended to better reflect private-market discount rates.

Add Preservation of Federally Assisted Affordable Housing to Allocation Criteria

Because the preservation and rehabilitation of existing affordable housing is often a more efficient way of supplying affordable housing than new construction and public resources may have already been expended in the development of existing affordable housing projects, this proposal would add the preservation of existing federally assisted affordable housing as an eleventh selection criterion that qualified allocation plans must include in order to encourage the preservation of existing federally assisted affordable housing projects.

Make LIHTC Beneficial to Real Estate Investment Trusts

This proposal would permit a real estate investment trust (REIT) to designate some of its distributed dividends as tax exempt, which would then be excluded from the gross income of shareholders receiving such dividends. The amount designated as tax exempt could not exceed the quotient of the REIT's LIHTCs for the year, divided by the highest corporate tax rate. If there is insufficient earnings and profit to pay the designated amount of dividends, the unused authority to designate tax-exempt dividends could be carried forward indefinitely. If a shareholder that receives these tax-exempt dividends is itself a REIT or a regulated investment company, the shareholder could designate a corresponding amount of dividends that it distributes to its shareholders as tax-exempt. In the case of any compliance failure, the REIT would be responsible for recapture of the LIHTC as if it had used the LIHTC to reduce its own tax liability. Under the proposal, the passive-loss and at-risk rules would not apply to the receipt of the exempt dividends.

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