HISTORIC TAX CREDIT COALITION

Achieving Cost Savings without Reducing the Value of the HTC

The Historic Tax Credit (HTC) provides owners of a historic building with a vehicle to raise the capital needed to complete projects that are almost always more difficult and costly than a regular renovation or new construction.

While the full 20% credit amount was maintained in the final tax reform bill, the credit was weakened by having it taken over five years. This change, combined with the repeal of the 10% credit for rehabilitating buildings built before 1936, is expected to generate over $2.6 billion in cost savings to the Treasury over a 10-year period. One consequence of this change, however, is that it will reduce the value of the credit to the projects that it is intended to incentivize.

The Historic Tax Credit Coalition proposes that a current provision of the tax law requiring a basis adjustment equal to the amount of the credit be eliminated to restore a portion of the value of the credit that is lost by the timing change of the credit. Eliminating the basis adjustment would also bring the HTC into line with the Low-Income Housing Tax Credit (LIHTC) which also does not require a basis adjustment.

<u>Time Value of Money Results in Reduction in Value of Credits</u>

- The value of a credit received in a single tax year compared to the value of the same credit received over a five-year period is different because of the time value of money principle. A credit received over time will be worth less to an owner or its investor than a credit received in full at placement in service.
- Assuming a 10% discount rate, the equivalent amount invested per credit would decrease by approximately 18%. Said another way, the revised 20% credit taken over the five-year period is equivalent to today’s credit of 20% being reduced to 16.4%.

<u>Other Provisions of Current Law Impact Value of Credit</u>

- A provision of the current HTC law requires that the basis of the building that is rehabilitated using the credit and the basis of the owner’s interest in the property must be reduced by the amount of HTC claimed. (Internal Revenue Code Section 50(c)). For example, a building with $100 of historic renovation work that generates a $20 tax credit will have its basis reduced by $20, resulting in an adjusted basis of $80.

- Since the basis is reduced, depreciation deductions over the tax life of the building are less than they would otherwise be in any other real estate transaction. In addition to the reduced value of the tax losses that would have been available through depreciation, the potential taxable gain upon sale of the building also increases.

- HTC transactions also permit a long-term tenant to earn the credit. In these so-called Master Lease transactions, rather than reduce the basis of the owner or the tenant’s property, IRC Section 50(d) requires the tenant to take the credit into income ratably over the property’s depreciable life. This has the same tax effect as the reduction in basis in the single entity transaction structure.

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- This basis adjustment provision makes the HTC effectively a taxable credit. As in every other context, if you tax something to the recipient, value decreases.

- Other credits are not treated as taxable credits. For example, the LIHTC, does not have a basis adjustment requirement and is not considered a taxable credit.

- The net effect of the taxability of the HTC, then, is to reduce the amount of investment, reducing the effectiveness of the credit.

Proposed Solution

- We propose to eliminate the basis adjustment requirement. We estimate that this would cost the Treasury only $215 million total over the 10-year period, while the value in the hands of building owners and their investors would be significantly more.

- This would have the positive effect of raising the value of the credit and mitigating most of the investment decreases that are expected because of the proposed 5-year credit delivery.

- By eliminating the basis adjustment, the HTC would mirror the LIHTC program, strengthen investment by maximizing the value of the credit to investors, and result in more dollars going into historic rehabilitations.