

The IRS 50(d) Regulations

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What is 50(d) Income?

Direct Investment (Single Tier Structure)

- Requires basis reduction equal to the amount of historic tax credit
- Basis reduction results in:
 - Fewer depreciation deductions
 - More gain or less loss upon sale of the project

Lease Pass Through (Two Tier Structure)

- No basis reduction at landlord level
- Master tenant recognizes annual income (referred to as 50(d) income)
 - $\text{Income} = \text{HTC} \div \text{shortest depreciable life}$
 - Phantom income
 - Example (assuming \$5MM of HTC):
 - Annual 50(d) income equals approximately \$181K/year for a residential project and \$128K/year for a commercial project

Why the need for regulations?

Underlying questions:

- 1) Is 50(d) income a partnership item or a partner item?
 - Historically treated as a partnership item throughout the industry
 - Varying positions as to whether it gave investor basis in its interest
 - Impact on transaction
 - Partnership item that gives investor basis in its interest gives rise to an additional capital loss benefit upon exit

- 2) What happens to the remaining unrecognized 50(d) income after the investor exits?
 - Does it stay with the remaining partners in the partnership
 - Is it accelerated? If so, to whom?
 - If accelerated and gives investor basis it could be a wash to the investor if they can use the capital loss
 - Varying positions taken historically throughout the industry

The 50(d) regulations

- IRS released amended regulations on July 21, 2016
- Apply to property placed in service on or after September 19, 2016
- Important takeaways:
 - The 50(d) income is a partner item
 - The 50(d) income goes to the person who claims the credits
 - The 50(d) income does not increase the investor's basis in its partnership interest
 - Post recapture period the 50(d) income continues to be claimed over the remaining depreciation period unless the claimant elects to accelerate
 - Election can only be made in the earlier of the year the claimant terminates its interest or the year the lease terminates

Pricing Impact of the Regulations

Case Study Assumptions:

- Historic tax credit - \$5,000,000
- Annual investor preferred return – 2% of contributed capital
- Investor put price – 5% of contributed capital
- Tax equivalency payments to investor during compliance period
- Residential property with 27.5 year depreciable life
- Corporate investor with a 35% tax rate
- Investor can use capital loss upon exit
- No tax equivalency payment post compliance period

Pre 50(d) Regulations

| Year | Capital Contributions | Tax Credits | Tax on 50(d) Income | Tax Priority Payment for 50(d) Income | Priority Cash Distributions | After Tax Benefit Upon Exit | Total Net Benefits |
|--------------|-----------------------|---------------------|---------------------|---------------------------------------|-----------------------------|-----------------------------|---------------------|
| 0 | \$ (5,000,000) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ (5,000,000) |
| 1 | | 5,000,000 | (63,636) | 63,636 | 100,000 | | 5,100,000 |
| 2 | | | (63,636) | 63,636 | 100,000 | | 100,000 |
| 3 | | | (63,636) | 63,636 | 100,000 | | 100,000 |
| 4 | | | (63,636) | 63,636 | 100,000 | | 100,000 |
| 5 | | | (63,636) | 63,636 | 100,000 | 1,944,317 | 2,044,317 |
| Total | \$ (5,000,000) | \$ 5,000,000 | \$ (318,180) | \$ 318,180 | \$ 500,000 | \$ 1,944,317 | \$ 2,444,317 |

IRR 23.5%
\$/Credit \$ 1.00

| Investor Exit Analysis | |
|---|----------------------------|
| Capital Contributions | \$ 5,000,000 |
| 50(d) Income (Compliance Period) | 909,086 |
| Acceleration of 50(d) Income | 4,090,914 |
| Distributions | (818,180) |
| Capital Account At Exit | 9,181,820 |
| Put Proceeds | 250,000 |
| Capital Loss Upon Exit | (8,931,820) |
| Tax Rate | 35% |
| Capital Loss Tax Benefit From Exit | <u>\$ 3,126,137</u> |
| Total After Tax Benefits from Exit | |
| Put Proceeds | \$ 250,000 |
| Capital Loss Tax Benefit From Exit | 3,126,137 |
| Tax on Accelerated 50(d) Income | (1,431,820) |
| Total After Tax Benefits from Exit | <u>\$ 1,944,317</u> |

Post 50(d) Regulation – No Acceleration at Exit

| Year | Capital Contributions | Tax Credits | Tax on 50(d) Income | Tax Priority Payment for 50(d) Income | Priority Cash Distributions | After Tax Benefit Upon Exit | Total Net Benefits |
|--------------|-----------------------|---------------------|-----------------------|---------------------------------------|-----------------------------|-----------------------------|---------------------|
| 0 | \$ (4,753,407) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ (4,753,407) |
| 1 | | 5,000,000 | (63,636) | 63,636 | 95,068 | | 5,095,068 |
| 2 | | | (63,636) | 63,636 | 95,068 | | 95,068 |
| 3 | | | (63,636) | 63,636 | 95,068 | | 95,068 |
| 4 | | | (63,636) | 63,636 | 95,068 | | 95,068 |
| 5 | | | (63,636) | 63,636 | 95,068 | 1,540,446 | 1,635,514 |
| 6-28 | | | (1,431,820) | | | | (1,431,820) |
| Total | \$ (4,753,407) | \$ 5,000,000 | \$ (1,750,000) | \$ 318,180 | \$ 475,341 | \$ 1,540,446 | \$ 5,583,967 |

| | |
|---------------------|--------------|
| IRR | 23.5% |
| Change in Equity | \$ (246,593) |
| \$/Credit | \$ 0.95 |
| Change in \$/Credit | \$ (0.05) |

| Investor Exit Analysis | |
|---|---------------------|
| Capital Contributions | \$ 4,753,407 |
| 50(d) Income (Compliance Period) | - |
| Acceleration of 50(d) Income | - |
| Distributions | (793,521) |
| Capital Account At Exit | 3,959,887 |
| Put Proceeds | 237,670 |
| Capital Loss Upon Exit | (3,722,216) |
| Tax Rate | 35% |
| Capital Loss Tax Benefit From Exit | \$ 1,302,776 |
| Total After Tax Benefits from Exit | |
| Put Proceeds | \$ 237,670 |
| Capital Loss Tax Benefit From Exit | 1,302,776 |
| Tax on Accelerated 50(d) Income | - |
| Total After Tax Benefits from Exit | \$ 1,540,446 |

Post 50(d) Regulation – Acceleration at Exit

| Year | Capital Contributions | Tax Credits | Tax on 50(d) Income | Tax Priority Payment for 50(d) Income | Priority Cash Distributions | After Tax Benefit Upon Exit | Total Net Benefits |
|--------------|-----------------------|---------------------|---------------------|---------------------------------------|-----------------------------|-----------------------------|---------------------|
| 0 | \$ (4,310,708) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ (4,310,708) |
| 1 | | 5,000,000 | (63,636) | 63,636 | 86,214 | | 5,086,214 |
| 2 | | | (63,636) | 63,636 | 86,214 | | 86,214 |
| 3 | | | (63,636) | 63,636 | 86,214 | | 86,214 |
| 4 | | | (63,636) | 63,636 | 86,214 | | 86,214 |
| 5 | | | (63,636) | 63,636 | 86,214 | 66,151 | 152,365 |
| Total | \$ (4,310,708) | \$ 5,000,000 | \$ (318,180) | \$ 318,180 | \$ 431,071 | \$ 66,151 | \$ 1,186,514 |

| | |
|---------------------|--------------|
| IRR | 23.5% |
| Change in Equity | \$ (689,292) |
| \$/Credit | \$ 0.86 |
| Change in \$/Credit | \$ (0.14) |

| Investor Exit Analysis | |
|---|------------------|
| Capital Contributions | \$ 4,310,708 |
| 50(d) Income (Compliance Period) | - |
| Acceleration of 50(d) Income | - |
| Distributions | (431,071) |
| Capital Account At Exit | 3,879,637 |
| Put Proceeds | 215,535 |
| Capital Loss Upon Exit | (3,664,102) |
| Tax Rate | 35% |
| Capital Loss Tax Benefit From Exit | \$ 1,282,436 |
| Total After Tax Benefits from Exit | |
| Put Proceeds | \$ 215,535 |
| Capital Loss Tax Benefit From Exit | 1,282,436 |
| Tax on Accelerated 50(d) Income | (1,431,820) |
| Total After Tax Benefits from Exit | \$ 66,151 |

Single Tier Structure

| Year | Capital Contributions | Tax Credits | Tax on 50(d) Income | Tax Priority Payment for 50(d) Income | Priority Cash Distributions | After Tax Benefit Upon Exit | Total Benefits |
|--------------|-----------------------|---------------------|---------------------|---------------------------------------|-----------------------------|-----------------------------|---------------------|
| 0 | \$ (4,367,198) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ (4,367,198) |
| 1 | | 5,000,000 | - | - | 87,344 | | 5,087,344 |
| 2 | | | - | - | 87,344 | | 87,344 |
| 3 | | | - | - | 87,344 | | 87,344 |
| 4 | | | - | - | 87,344 | | 87,344 |
| 5 | | | - | - | 87,344 | 218,360 | 305,704 |
| Total | \$ (4,367,198) | \$ 5,000,000 | \$ - | \$ - | \$ 436,720 | \$ 218,360 | \$ 1,287,881 |

| | |
|---------------------|--------------|
| IRR | 23.5% |
| Change in Equity | \$ (632,802) |
| \$/Credit | \$ 0.87 |
| Change in \$/Credit | \$ (0.13) |

| Investor Exit Analysis | |
|---|-------------------|
| Capital Contributions | \$ 4,367,198 |
| Basis Reduction | (5,000,000) |
| 50(d) Income (Compliance Period) | - |
| Acceleration of 50(d) Income | - |
| Distributions | (436,720) |
| Capital Account At Exit | (1,069,521) |
| Put Proceeds | 218,360 |
| Capital Gain Upon Exit | 1,287,881 |
| Tax Rate | 35% |
| Capital Gain From Exit | \$ (450,758) |
| Total After Tax Benefits from Exit | |
| Put Proceeds | \$ 218,360 |
| Capital Gain From Exit | (450,758) |
| Tax Priority Payment for Gain on Exit | 450,758 |
| Tax on Accelerated 50(d) Income | - |
| Total After Tax Benefits from Exit | \$ 218,360 |

Thank you!

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