McKonly & Asbury

# Tax Planning Strategies for Affordable Housing Developers

macpas.com

# Introductions

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# Firm Overview

## McKonly & Asbury

M&A is a team of CPAs and Business Advisors serving clients from our offices in Camp Hill, Lancaster, Bloomsburg, and Philadelphia.

## Services Provided

- Advisory & Business Consulting
- Audit & Assurance
- Entrepreneurial Support & Outsourced Accounting
- Internal Audit
- Professional Placement
- Tax
- Technology

## Industries Served

- Affordable Housing
- Architecture, Engineering, and Construction (AEC)
- Employee Benefit Plans
- Family-Owned Business
- Healthcare
- Manufacturing & Distribution
- Nonprofit

# Affordable Housing Services

McKonly & Asbury is a recognized leader in providing audit, tax, and consulting services to owners, developers, and property management organizations.

- Financial Statement Audits, Reviews, and Compilations
- Tax Return Preparation
- 10% Tests
- 50% Tests
- Development Cost Certifications
- LIHTC Consulting
- Agreed-Upon Procedures
- Property Compliance Consulting

Learn more at macpas.com/industries/affordable-housing

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# ABOUT KBKG

Established in 1999 with offices in major markets throughout the US, KBKG is one of the oldest and largest independent providers of specialty tax studies in the country. By focusing exclusively on value-added tax services, we complement your traditional tax and accounting team.

## SINGLE SOURCE SOLUTION

We are unique in the marketplace as we offer a single source solution for a number of specialty tax services.
We provide you with a single point of contact who will interject the appropriate subject matter expert within our team as necessary. We help determine which tax programs benefit clients and stay committed to handling each relationship with care and diligence.

## SEAMLESS TEAMWORK & COLLABORATION

Our ability to work seamlessly with your team is the reason so many tax professionals and businesses across the nation trust KBKG.

Our practice is staffed by full-time specialists with engineering, valuation, "green" building, estimating, and construction backgrounds as well as tax professionals, attorneys, and CPAs.

## SERVICES

- R&D Tax Credits
- Cost Segregation for Buildings and Improvements
- Green Building Tax Incentives
- Transfer Pricing Services
- IC-DISC
- Fixed Asset Review
- Repair vs. Capitalization Review
- Employment Tax Credits

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# Cost Segregation

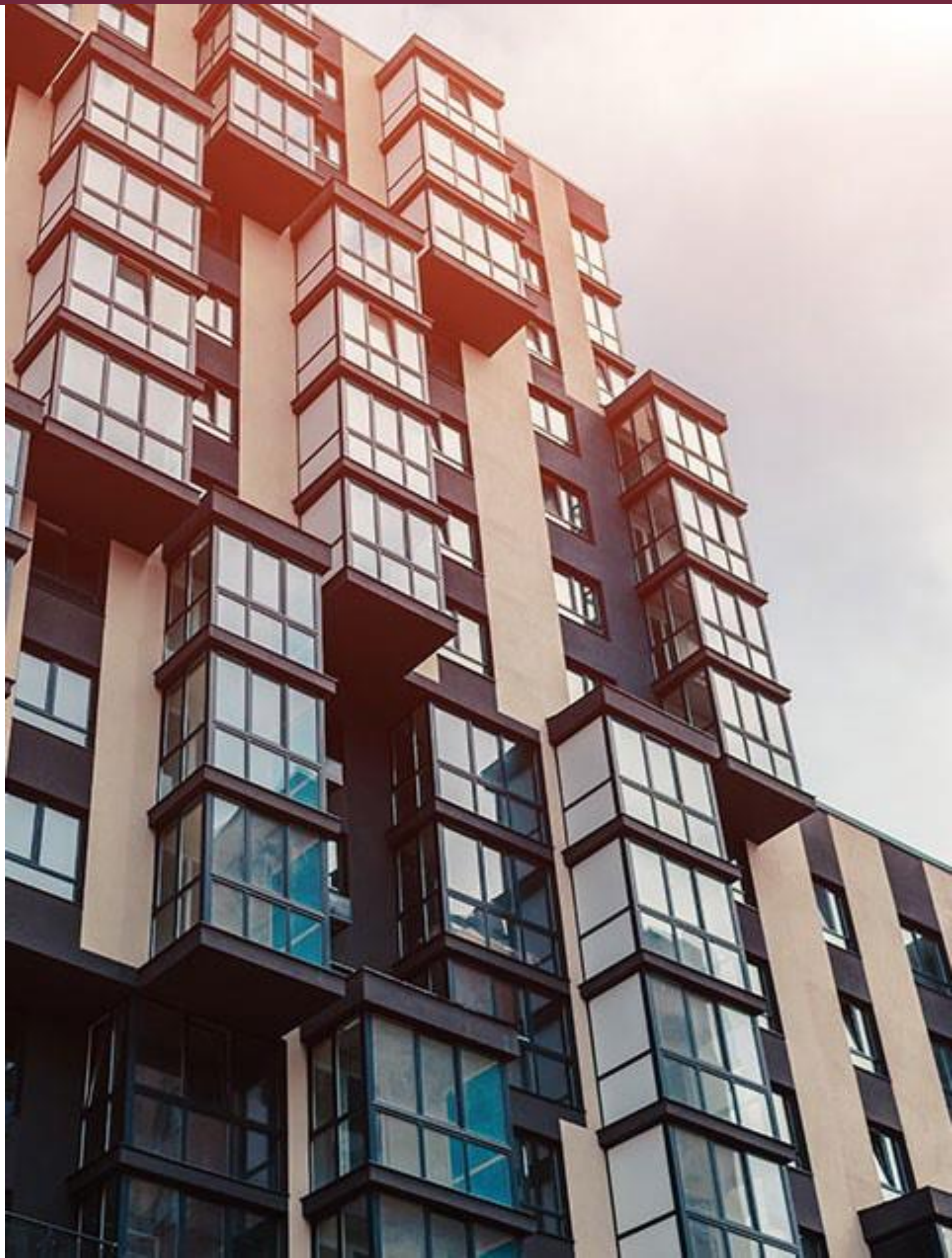
# WHAT IS COST SEGREGATION?

**Primary goal: Identify all property-related costs that can be depreciated faster (typically with a 5, 7 or 15 years tax life)**

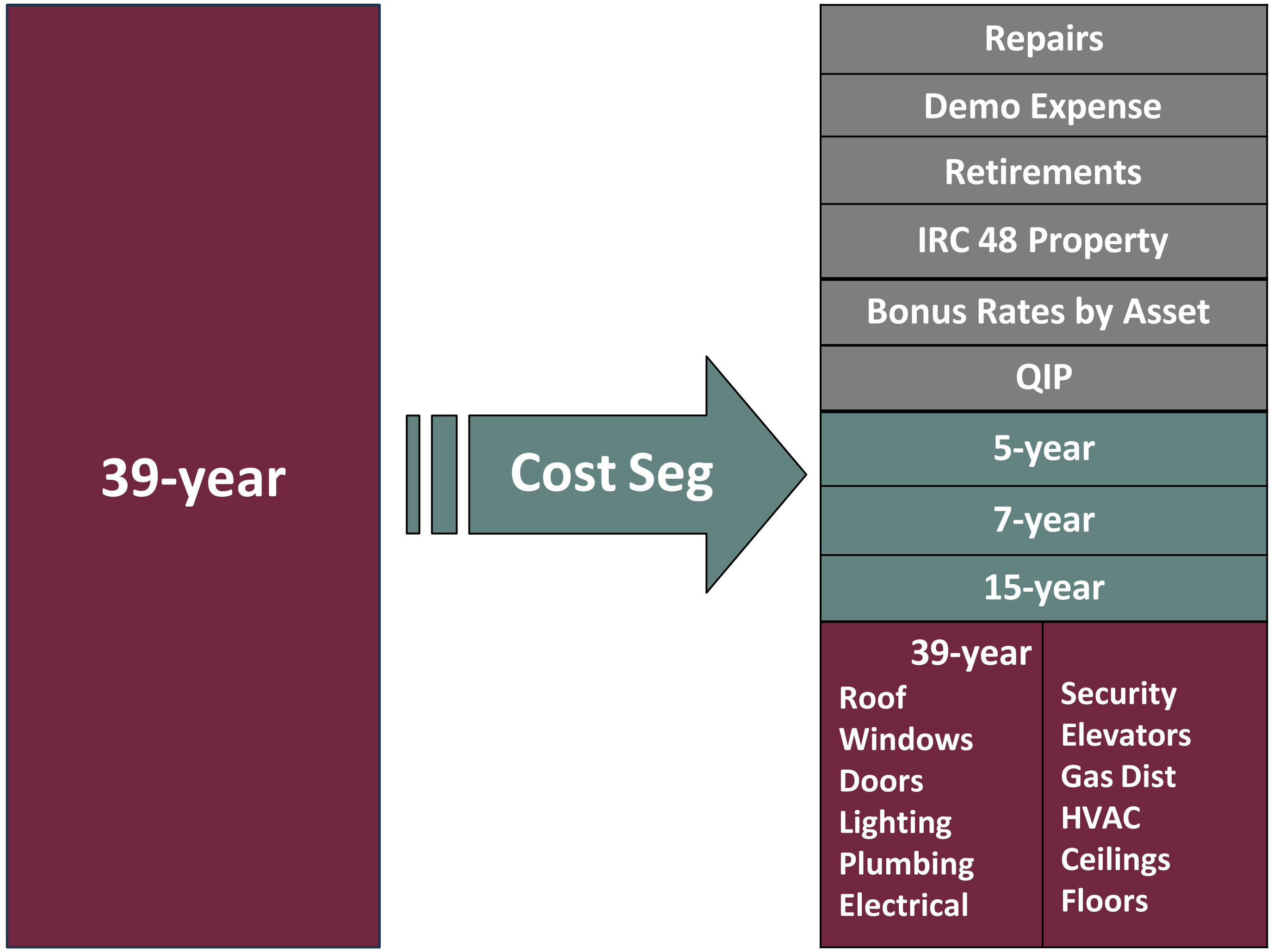
- Taking tax deductions earlier increases cash flow
- Creates a time value of money benefit by having cash now and not later

**Secondary goal: Establish the depreciable tax value for each major building component that is likely to be replaced in the future**

- Examples include the roof, windows, doors, bathroom fixtures, HVAC, etc.
- Tax preparer's need this information to claim a "retirement loss" or "partial disposition" deduction for the remaining depreciation left on that component.



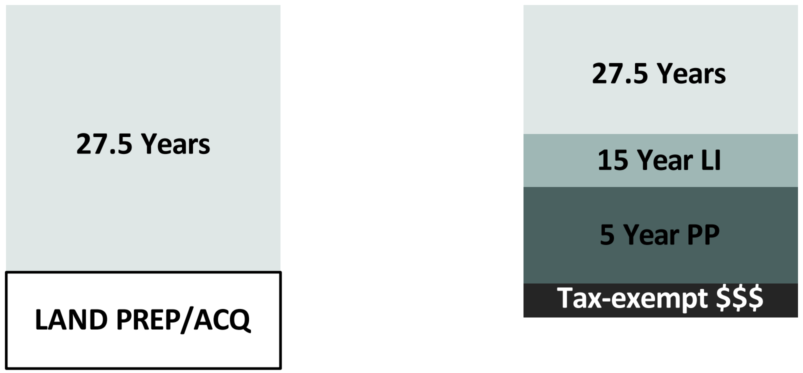
# KBKG ENHANCED COST SEGREGATION STUDIES



# CASE STUDY: APARTMENT BUILDING

- 115,000 SF 100-unit low-rise garden style apartment building construction and extensive site amenities
- Constructed in 2023 for $30 million

**Without Cost Seg** | **With a Cost Segregation Study**




**5 Year Property: <u>$5.7M</u>**

**15 Year Property: <u>$2.7M</u>**

**Tax-exempt bond financing: <u>$????M</u>**

**First Years Increased Deductions: <u>$6.8M</u>**

**First Year Tax Savings (Cash Flow): <u>$1.5M</u>**

**NPV of Tax Savings (over 28yr Life): <u>$900k</u>**

- Highlights of the Analysis:
  - Land acquisition or land preparation related development is non-depreciable
  - Depreciable basis and LIHTC basis reduced by any tax-exempt financing
  - Land improvements + Personal property reclassification (w/ 80% bonus)
  - UoP bldg. by bldg. for future dispositions

# COST SEGREGATION – TAX PLANNING TOOL

**One of the most common tax planning tools for anyone with real estate**

- Performed in year purchased – simply report the allocations on depreciation schedule

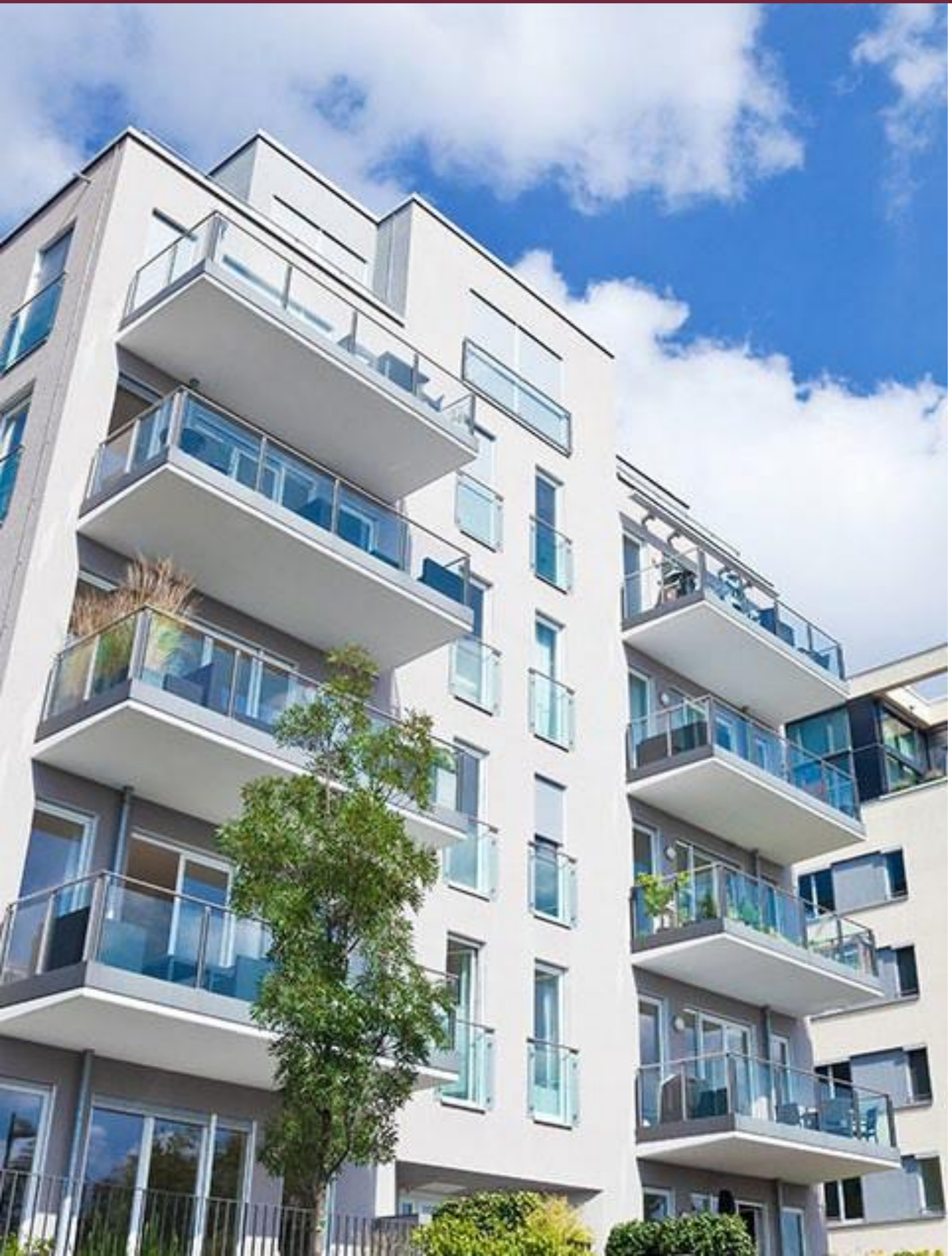
**Can be done anytime after the building is purchased**

- No amended tax returns
- File a Form 3115 and claim any missed deductions in year performed.
- Allows tax preparers to plan when to use deductions

**Rule of Thumb: viable if building basis is > $750K (excluding land)**

**Modified Rule of Thumb: can use online software for residential properties if building basis > $150k**

- https://www.kbkg.com/residential-costsegregator



# TAX CONSIDERATIONS

- Depreciation deductions will reduce AMT
- On new construction, bonus depreciation can apply to reclassified items in a cost segregation study which magnifies the benefit
- Unused deductions carry forward
- When building is sold, the taxpayer may need to recapture depreciation taken on personal property
- Accounting method changes are addressed with IRS Form 3115
- Passive activity rules can offset the benefits of cost segregation
- 1031 exchange rules need to be considered

# BONUS DEPRECIATION

**Original Use guidance remains essentially the same as prior guidance under 1.168(k)**

- General Bonus Depreciation Requirements:
  - Must be property of a specified type
  - Original use of the property must commence with the taxpayer or if used depreciable property must meet certain acquisition requirements
  - Must be placed in service by the taxpayer within the specific time period
    - Must be acquired by the taxpayer after 9/27/17
    - If acquired before 9/28/17 – property is subject to “old” bonus rules

**Bonus on new AND USED PROPERTY starting in 2018**

**Bonus depreciation is MANDATORY**

- Otherwise must formally elect out of bonus annually on a class by class basis

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# 45L Tax Credit for Energy Efficient New Homes

# 45L Tax Credit – 2021 through 2022

- Introduced in 2006; extended numerous times prior to last sunset at end of 2021

- Inflation Reduction Act extends retroactively for 2022
  - Tax credit remains at $2,000 per unit leased or sold until end of 2022
    - Benefit example: 100 units would be eligible for up to $200,000 in credits
    - Energy efficiency criteria is same as recent prior years
      - Heating & cooling savings simulated at 50% less compared to 2006 IECC
      - Building envelope related savings at least 10% less compared to 2006 IECC

- Eligible buildings include:
  - Single family homes
  - Low-rise residential buildings (*3-stories or less*)
    - Significant rehab & reconstruction is eligible

# 45L Tax Credit – 2021 through 2022

- Eligible taxpayers include:
  - Homebuilders
  - Multifamily developers

- What’s required?
  - Energy simulation modeling
  - Post construction Field Inspections
  - Third party certification by qualified professional

# 45L Tax Credit – 2023 to 2032

- Inflation Reduction Act extends through 2032
- Eligible taxpayers include:
  - Homebuilders
  - Multifamily developers

| Building Type | ENERGY STAR | | ZERH | |
|---|---|---|---|---|
| | Base Rate | Bonus Rate (5x) | Base Rate | Bonus Rate (5x) |
| Multifamily | $500 | $2,500 | $1,000 | $5,000 |
| Single Family | $2,500 | - | $5,000 | - |

- Prevailing wage requirements lead to 5x the tax credit
  - No prevailing wage safe harbor like 179D
  - No Apprenticeship requirements

# 45L Tax Credit – 2023 to 2032

- Prevailing Wages
  - Activity
  - # of stories
  - Project location

- When do multifamily developers pay prevailing wages?
  - Affordable Housing Projects
    - Funding condition
      - e.g., HUD (d)(4) Loans, HUD HOME Funds
  - State specific laws
    - e.g., SB6 (CA), Section 8 Vouchers
  - Union Projects
  - Labor shortage
    - Skilled labor

# 45L Tax Credit – 2023 to 2032

- Other key changes:
    - Eligible buildings
        - No height limit; mid-rise, high rise & mixed use 50% now eligible
            - Full gut rehabs only
    - Affordable Housing
        - 45L doesn't reduce basis eligible for LIHTC
            - Pay Prevailing Wages
            - Energy Efficient
            - Overlap with other certification programs (*e.g., NGBS, Enterprise Green, LEED, etc*.)

# 45L Tax Credit – 2023 to 2032

- What's Required at the $500 to $2,500 level:
  - Construction Related Requirements
    - Air Sealing, Reduced Thermal Bridging, Properly Installed Insulation, Ventilation, etc.
  - Energy Efficiency Measures
    - Identified via simulation modeling (*e.g., SEER, DHW EF, etc*.)
  - 3rd Party Inspections & Diagnostic Testing
    - Verifications & Inspections required throughout construction
    - Preconstruction planning before construction breaks ground

# 45L Tax Credit – 2023 to 2032

- What's Required at the $1,000 to $5,000 level:
  - Construction Related Requirements & Materials
    - Fenestration, Insulation levels, indoor HVAC & Duct Distribution location
    - Radon mitigation based on project location
  - Additional Energy Efficiency Measures
    - Identified via simulation modeling (*e.g., SEER, DHW EF, etc*.)
  - Product Related Requirements
    - Indoor Air Quality (*e.g., Low VOC cabinetry, paint, floor coverings, etc*.)
    - Future Readiness (*e.g., Solar, HPWH, EV charging, etc*.)
  - 3rd Party Inspections & Diagnostic Testing
    - Verifications & Inspections required throughout construction
    - Preconstruction planning before construction breaks ground

# 45L Tax Credit – 2023 to 2032

- What should I do?
  - Be proactive
  - Reach out to developers
  - Understand their pipeline
  - Set up a call with KBKG to get us involved early

# Summary of 45L Changes

| | 45L (2021 to 2022) | 45L (2023 to 2032) |
|---|---|---|
| Energy Efficiency Requirements | 50% Savings vs 2006 IECC | Energy Star / ZERH |
| Credit per unit SFH (Homebuilders) | $2,000 | $2,500 to $5,000 |
| Credit per unit (Multifamily Developers) | $2,000 | $500 to $1,000 |
| Credit per unit (Multifamily Developers) Meeting Prevailing Wage Requirements | $2,000 | $2,500 to $5,000 |
| Story Height Limit | Yes (3 stories or Less) | No |
| Reduce basis for calculating LIHTC | Yes | No |
| Rehab & Reconstruction | All Types Eligible | Full gut rehab only |
| Certification Process | Post-construction | Pre-construction |


# ITC 48 + IRA Snapshot

# INFLATION REDUCTION ACT SNAPSHOT

- Created and modifies several renewable energy credits
- Effective for tax years beginning on or after January 1, 2023
- Created Code Section 6417
  - A tax-exempt organization, State, Indian tribal government, etc. (applicable entity) may elect to be treated as making a federal income tax payment equal to the amount of the energy credit.
- Created Code Sec. 6418
  - A taxpayer that is not an applicable entity may elect to transfer all or a portion of the credit to an unrelated taxpayer
- In the past year, Treasury and IRS have released guidance

# APPLICABLE ENERGY CREDITS

Types of credits eligible for Direct pay and Transferability:

- Section 48 energy investment tax credit ("ITC")
- Section 45 renewable energy production credit ("PTC")
- Section 45Q carbon capture credit
- Section 48C qualifying advanced energy project credit
- Section 45U zero-emission nuclear power production credit
- Section 45V clean hydrogen production credit
- Section 45X advanced manufacturing production credit
- Section 45Y clean electricity production credit
- Section 45Z clean fuel production credit
- Section 30C credit for alternative fuel refueling property

Common Energy Credit - Not eligible for Transferability / Eligible for Direct Pay

- Section 45W - commercial clean energy credit

# TAX CREDIT TRANSFERABILITY

- The IRA allows for tax transfers of 11 different type of renewable energy tax credits, including the common Section 48 – Investment Tax Credit and Section 45 – Production Tax Credit
- Tax credit transferability market facilitates the purchase of credits at a discount with a shortened investment period
- Current market seeing transactions ranging from $.80 - $.93 with pricing depend upon project / credit size, energy technology utilized, creditworthiness of seller and the existence of indemnification / tax insurance
- **5-Year Recapture Period – Buyer would have to repay IRS for any recapture event**
  - **Recapture Risk**
    - Project sold
    - Developer goes bankrupt
    - ITC computation error
  - Cost Segregation / Certification mitigates this risk.

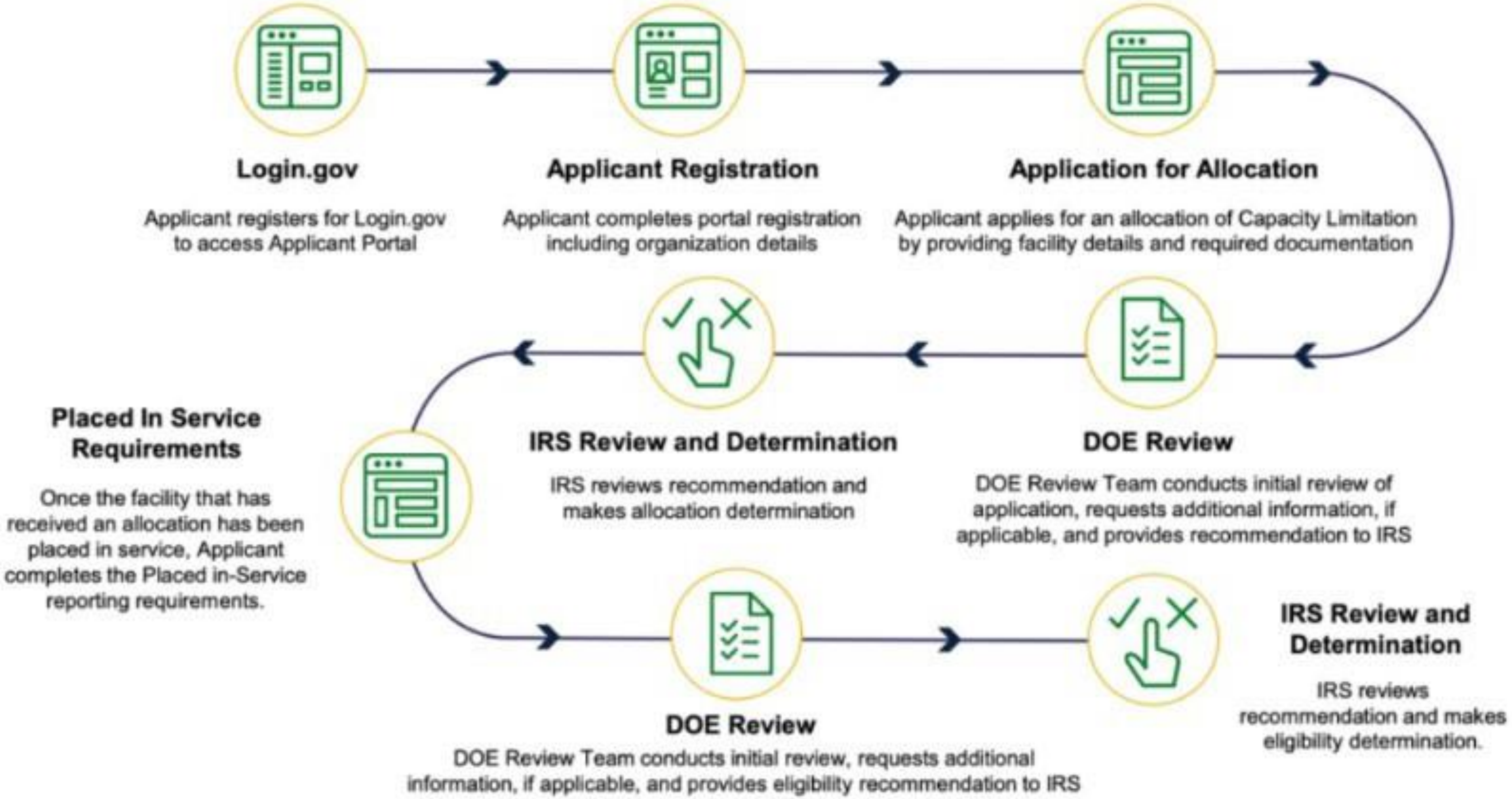
# BONUS CREDITS

- The IRA created three bonus credits, or 'adders', for which projects can qualify:
  - Energy Community Bonus
  - Domestic Content Bonus
  - Low-Income Community Bonus
- Each bonus has specific eligibility requirements that a project must meet
- Bonus credits are not treated differently from base credits for the purpose of transferability

# LOW-INCOME COMMUNITIES BONUS CREDIT PROGRAM

- Provides an increased credit of 10 percentage points or 20 percentage points to certain applicable credits that are part of the investment tax credit (sections 48, 48E) for certain facilities in one of four categories.
  1. located in a low-income community (10%)
  2. located on Indian land (10%)
  3. installed on certain federal housing projects (20%)
  4. serving low-income households (20%)
- Facilities with a maximum net output of less than five megawatts (AC)
- DOE will review applications and make recommendations to the IRS, which will allocate to up to 1.8 gigawatts (GW) of eligible solar and wind capacity per year

# APPLICATION PROCESS OVERVIEW



# TRANSFERRING ENERGY CREDITS

How to buy and sell credits:

- Credits can only be transferred once
- Taxpayers must be unrelated parties
- Must be purchased solely for cash
- Once the purchase agreement is in place, a transfer election statement must be arranged between buyer and seller
- Taxpayers must complete pre-filing registration with the IRS if they intend to transfer all or a portion of an eligible credit. (Unique Registration ID received for each qualified project)

- **Passive Activity Rules must be considered**
- **Cash received for credits is not considered taxable income for seller**
- Unused credits can be carried back 3 years or forward 22 years

# BUSINESS FEDERAL ENERGY TAX CREDITS – TRANSFERABILITY

- **KBKG Advantage (How we can help):** Turnkey Process
  - Working with reputable solar developers
    - KBKG providing **diligence by performing cost segregation analysis to establish eligible cost basis for ITC**
      - Cost Segregation is required by all Tax Insurance companies
      - Buyers of uninsured credits are requiring a Cost Segregation
  - Review due diligence reports provided by seller of credits
  - Authenticate tax credit calculation
  - Understand pricing, payment terms, guarantees and warranties provided by seller
  - Registration Process
  - Prevailing Wage and Apprenticeship Consulting
    - Reviewing Certified Payroll from Contractors
  - For Direct-Pay – more consulting involved
    - Understanding funding sources
    - Domestic Content Exceptions
    - Filing of Form 990-T

# Contact Information

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# Upcoming Events

# December 19 Webinar


## Income Taxes – So Where Do We Go From Here?

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