News

IRS Issues Historic Rehabilitation Credit Safe Harbor

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As anticipated the IRS has finally issued guidelines for transactions involving historic/rehab tax credits. The guidelines may be found in Revenue Procedure 2014-12.

The guidelines are an attempt to create a "safe harbor" in which the historic tax credit market can function.

The guidelines address transactions where the investor receives the credits through an ownership interest in a partnership (which owns and develops a historic building) or transactions where a partnership passes the credits to a master tenant owned by the investor (master lease structure).

The most important provisions of the safe harbor are as follows:

- The investor must put at least 20% of its anticipated total investment in at inception. The rest can be paid over time, but at least 75% of the expected total investment must be fixed in amount prior to the building being placed in service.
- The Investor's share of partnership income, losses and tax credits cannot be less than 5% of its highest allocation percentage over the life of the deal. For example, if the investor starts out being allocated 99% of income, losses and tax credits, then its share cannot flip down to less than 5% of 99%, or 4.95%.
- The sponsor must have at least a 1% interest in income, losses and tax credits.
- The investor's partnership interest must have "a reasonably anticipated value commensurate with the Investor's overall percentage interest" apart from tax benefits. The value should not be fixed.
- The investor cannot be protected from losses from partnership activity and must participate in profits in a manner not limited to a preferred return.
- The sponsor cannot strip out cash through developer, management or other incentive fees that are above what a third party would be paid for the same services in a non-tax credit deal. It cannot be distributed a disproportionate amount of cash. For example, the sponsor cannot receive all the cash above preferred cash distributions to the investor.
- Guarantees to the investor must be limited to guarantees with respect to any act or omission which would prevent the partnership from qualifying for the credit. As such, the sponsor can promise to do things that are required for the partnership to be entitled to tax credits and to avoid recapture. It can provide completion guarantees, operating deficit guarantees, environmental indemnities and make financial covenants. However, these guarantees cannot be "funded," meaning the sponsor cannot set aside money or property to ensure payment on the guarantees. It can only fund a reserve to cover up to 12 months of reasonably projected partnership operating expenses.

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- The sponsor cannot indemnify the tax equity investor against loss of tax credits or guarantee the "cash equivalent of tax credits". It cannot agree to make capital contributions to the partnership to ensure the partnership will have enough cash to make cash distributions to the investor. The sponsor cannot pay the investor's "costs" or indemnify it for its "costs" if the IRS challenges the tax credits the investor claimed.
- Neither the sponsor nor the partnership can have a call option to repurchase the investor's interest in the future. However, the tax equity investor can have a "put" to force the sponsor to repurchase the interest, as long as the put price is not above fair market value when the put is exercised.

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