MEMORANDUM

"…meeting community needs…enhancing quality of life."

TO: Mayor and Common Council

FROM: Karen Harkness, Director of Community & Economic Development

DATE: December 17, 2017

RE: Proposed Tax Reform Bill – Impacts to Real Estate Incentives and Historic Tax Credits

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The House of Representatives' tax reform proposal was released on November 2, 2017, and the Senate's tax reform proposal was released on November 9, 2017. The two proposals were vastly different. Numerous amendments were made to each bill, and on December 2, 2017, the Senate passed the Tax Cuts and Jobs Act by party line vote of 51-49.

Substantial differences between the bills are expected to be reconciled in a Conference Committee over the next several hours/days. House and Senate Republicans have come to an agreement on the tax bill, and as of today, they intend to pass this bill before Congress goes on recess on December 22, 2017.

Both versions of the bill include several provisions that directly impact real estate development incentives, including Historic Tax Credits, incentives from Wisconsin Economic Development Corp., Tax Incremental Financing, New Market Tax Credits, Enterprise Zone Tax Credits and others.

The City of Appleton relies on many of these economic development tools to implement our Comprehensive Plan, Economic Development Strategic Plan and the City of Appleton Strategic Plan.

Because of these very recent changes at the Federal Level and the depth of impact on local proposed development projects, the Appleton Common Council is being asked to consider approval of two development agreements on Wednesday, December 20, 2017 during a special Committee of the Whole.

Historic Tax Credits

Proposed Changes: Under the House bill, both the 20 percent historic tax credit (HTC) and the 10 percent rehabilitation tax credit would be repealed for qualified rehabilitation expenditures (QRE) paid or incurred after December 31, 2017. Under the Senate bill, the 20 percent HTC would remain in effect, but the credit would be claimed annually over 5 years beginning with the date the QREs are placed in service. Both versions of the proposed bill eliminate the 10 percent rehabilitation tax credit for QREs paid or incurred after December 31, 2017.

Impact: Both proposed bills would allow a taxpayer to claim rehabilitation tax credits under the existing rules, as long as the taxpayer owns or leases the building continuously after December 31, 2017 and the 24 month substantial rehabilitation period begins within 180 days of enactment of the repeal or modification.

Planning Opportunity: Developers that are planning a rehabilitation of a historic building need to have their property acquisition and ownership completed and/or formed by December 31, 2017. If the rehabilitation credits are eliminated (proposed House bill), developers should be able to continue to close on historic tax credit syndication through 2019 as long as the development partnership owns or leases the building by December 31, 2017 and completes the rehabilitation by 2020 (2023 for phased projects).

Section 118 - Grant Structuring Changes

Proposed Changes: Under the House bill, Section 118 would be repealed, effective upon enactment, immediately making grant proceeds taxable upon receipt. The Senate bill does not propose any modification to Section 118.

Impact: Section 118 has often been used by developers to defer the tax impact of grant incentives by structuring the grant to be made to a corporation. Repealing Section 118 would require a for profit developer to pay federal and state income taxes upon receipt of grant proceeds to help fund a real estate development project. A repeal of Section 118 would substantially impact the capital stack of development projects.

Planning Opportunity: Since repeal would be effective upon enactment, developers with existing Section 118 should attempt to accelerate the completion of Developer's Agreements (DA) or what the proposed bill calls Master Agreement (MA). Developers should review the impact of the grant proceeds and create or revise capital stack.

Section 13312 - Taxation of Capital Contributions

Proposed Changes: Under the House bill, a new concept would require partnerships/corporations to recognize taxable income upon receipt of capital contributions, including any contributions by any governmental entity or civic group. Under the December 2, 2017 release, the date of enactment would be the date this legislation is signed by the President.

Impact: This provision would be problematic in structuring several common real estate development financing transactions. For example, in most transactions that involve the syndication of federal and/or state tax credits, the value of the partnerships/corporations interest that tax credit investor receives is often lower than their capital contribution. This is due to the project's cost routinely exceeding the value of the completed project. The impact of this amendment, if enacted, would require partnerships and corporations to recognize taxable income from the receipt of capital contributions from tax credits, TIF's, WEDC, etc.

Planning Opportunity: This provision would impact transactions that have previously closed or are currently in the process of closing, to the extent that the investor has not made all of its capital contributions as of the date the tax reform bill is enacted. Developers should monitor the status of the tax reform legislation to determine if such provision could create a funding gap equal to the amount of tax required to be paid on the capital contributions from the tax credit investor.

This version also has an exception to this amendment. The exception allows for this amendment to not apply as long as contributions after the enactment date are pursuant to a master development plan approved by a government entity prior to the enactment date.

* Sources used to write this memo include: Information from Plante Moran, Baker Tilly, Congress.gov, GOP.gov, and the Tax Policy Center.