Revised Rev. Proc. 2014-12 Clarifies New Guidance on Rehabilitation Tax Credits

01.13.2014

BY: J. PATRICK BECKER, JENNY H. CONNORS, ALLISON T. DOMSON, J. CONRAD GARCIA AND CRAIG L. RASCOE

On January 9, 2014, the Internal Revenue Service ("IRS") issued a revised version of previously released Rev. Proc. 2014-12, providing a safe harbor for the allocation of IRC Sec. 47 rehabilitation tax credits in tax credit partnerships under IRC Sec. 704(b). For the Alert previously provided to readers by our Business Tax Group analyzing the original Rev. Proc. 2014-12,click here. The changes reflected in the revised version provide additional clarity as to how rehabilitation tax credit allocations fit into the larger tax equity scheme and the associated market for investors.

Passing-Through Rehabilitation Tax Credits to Lessees

The IRS clarified that IRC Sec. 50(d)(5), providing rules for the computation of the investment credit, allows a lessor to elect to treat the lessee as having acquired the property for rehabilitation tax credit purposes if specific requirements are met. These requirements include the income inclusion requirement of former IRC Sec. 48(d)(5).

In the event that the lessor wishes to pass-through its allowable rehabilitation tax credit to the lessee, the lessor is not required to reduce its basis, depreciable or otherwise, by the amount of the rehabilitation tax credit. Instead, the former IRC Sec. 48(d)(5)(b), as referenced by IRC Sec. 50(d)(5), requires the lessee to include in its gross income an amount equal to the allowable rehabilitation tax credit spread over the depreciation period. As a benefit to the lessee, the included income increases its basis and capital accounts. Thus, the owners of the lessee are able to have a reduced capital gain or, perhaps, even a capital loss upon further disposition of the lessee membership interests.

The question of the treatment of a lessee of rehabilitation tax credit property upon the early disposition of that property remains unanswered. Proposed Treasury Regulations under the former IRC Sec. 48 provide that the lessee must take into account the excess of non-recaptured tax credits over the amount of income previously recognized.

The IRS further stated that Rev. Proc. 2014-12 does not provide the method for allocating the income inclusion required under IRC Sec. 50(d)(5). Given that the IRS has not promulgated guidance on that subject, the revised Rev. Proc. 2014-12 permits taxpayers to ignore allocations required under IRC Sec. 50(d)(5) in determining whether allocations made under their partnership agreements satisfy the partnership allocations rules of IRC Sec. 704(b).

Fair Market Value Determination for Call and Put Options

In addition, the revised Rev. Proc. 2014-12 altered how the fair market value of an investor's partnership interest is calculated. The original version of Rev. Proc. 2014-12 enabled an investor to have a contractual right to put its partnership interest at a future date to another person involved in the rehabilitation transaction so long as the price did not exceed the fair market value of the interest at the time of exercise. The revised language provides that the determination of fair market value may only take into account arm's length arrangements creating rights or obligations that are reasonable as compared to a real estate development project that does not qualify for IRC Sec. 47 rehabilitation tax credits.

Conclusion

The revised Rev. Proc. 2014-12 clarifies the continuing application of income inclusion requirements with respect to the pass-through of rehabilitation tax credits to lessees and changes the determination of fair market value of investor partnership interests for put option purposes. As the tax credit equity community continues to digest the long-awaited guidance of Rev. Proc. 2014-12, it remains unclear whether the mixture of clearly delineated rules and general principles will provide a jumpstart to the historic rehabilitation tax credit industry. For further questions about this revised Revenue Procedure, please contact one of the authors of this tax alert or a member of our firm's Business Tax Group.

Related People

- Jenny H. Connors – 804.420.6582 – jconnors@williamsmullen.com
- Allison T. Domson – 804.420.6915 – adomson@williamsmullen.com
- J. Conrad Garcia – 804.420.6910 – cgarcia@williamsmullen.com
- Craig L. Rascoe – 804.420.6472 – crascoe@williamsmullen.com

Related Services

- Tax Law
- Tax Credits