

**DESCRIPTION OF SUBTITLE F — INFRASTRUCTURE FINANCING
AND COMMUNITY DEVELOPMENT:
BUDGET RECONCILIATION LEGISLATIVE RECOMMENDATIONS**

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INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of Subtitle F — Infrastructure Financing and Community Development: Budget Reconciliation Legislative Recommendations. This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of Subtitle F — Infrastructure Financing and Community Development: Budget Reconciliation Legislative Recommendations* (JCX-36-21), September 11, 2021. This document can also be found on the Joint Committee on Taxation website at www.jct.gov. All section references herein are to the Internal Revenue Code of 1986, as amended (herein “Code”), unless otherwise stated.

SUBPART F — INFRASTRUCTURE FINANCING AND COMMUNITY DEVELOPMENT

A. Bond Financing

1. Credit to issuer for certain infrastructure bonds

Present Law

In general

Interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes.² Because of the income exclusion, investors generally are willing to accept a lower interest rate on tax-exempt bonds than they might otherwise accept on a taxable investment. This, in turn, lowers the borrowing costs for the beneficiaries of such financing.

As an alternative to tax-exempt interest, a variety of tax credit and direct pay bonds have been authorized, subject to applicable requirements, to lower borrowing costs on certain bonds issued by State and local governments. The interest on these bonds is taxable to the bondholder. Because of the tax credit available to the holders of tax credit bonds, investors generally are willing to accept a lower interest rate than they might otherwise accept on a taxable investment. For direct pay bonds, the issuer of the bond receives a payment from the federal government to offset a portion of the interest expense on the bonds.

State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes (“qualified private activity bonds”) and other Code requirements are met.

Private activity bonds

The Code defines a private activity bond as any bond that satisfies (1) the private business use test and the private security or payment test (the “private business test”); or (2) the “private loan financing test.”³

² Sec. 103.

³ Sec. 141.

Private business test

Under the private business test, a bond is a private activity bond if it is part of an issue in which:

1. More than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the trade or business of any person other than a governmental unit (“private business use”); and
2. More than 10 percent of the payment of principal or interest on the issue is, directly or indirectly, (a) secured by property used or to be used for a private business use or payments in respect of such property or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use (“private payment test”).⁴

A bond is not a private activity bond unless both parts of the private business test (*i. e.*, the private business use test and the private payment test) are met. Thus, a facility that is 100 percent privately used does not cause the bonds financing such facility to be private activity bonds if the bonds are not secured by or paid with private payments. For example, land improvements that benefit a privately-owned factory may be financed with governmental bonds if the debt service on such bonds is not paid by the factory owner or other private parties.

Private loan financing test

A bond issue satisfies the private loan financing test if proceeds exceeding the lesser of \$5 million or five percent of such proceeds are used directly or indirectly to finance loans to one or more nongovernmental persons. Private loans include both business and other (*e. g.*, personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test.

Arbitrage requirements

The exclusion from income for interest on State and local bonds does not apply to any arbitrage bond.⁵ An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher yielding investments or to replace funds that are used to acquire higher yielding investments.⁶ In general, arbitrage profits may be earned only during specified periods (*e. g.*, defined “temporary periods”) before funds are needed for the purpose of the borrowing or on specified types of investments (*e. g.*, “reasonably required reserve or replacement funds”). Subject to limited

⁴ The 10 percent private business test is reduced to five percent in the case of private business uses (and payments with respect to such uses) that are unrelated to any governmental use being financed by the issue.

⁵ Sec. 103(a) and (b)(2).

⁶ Sec. 148.

exceptions, arbitrage profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Prior tax credit and direct pay bonds

In general

As an alternative to tax-exempt interest, a variety of tax credit and direct pay bonds have been authorized, subject to applicable requirements, to lower borrowing costs on certain bonds issued by State and local governments, including the Build America Bonds program, part of the American Recovery and Reinvestment Act of 2009 (“ARRA”).⁷ The authority to issue new tax credit and direct-pay bonds was prospectively repealed by An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, also known as the Tax Cuts and Jobs Act of 2017 (“TCJA”),⁸ effective for bonds issued after December 31, 2017. The authority to issue two types of tax-credit and direct pay bonds, recovery zone economic development bonds and Build America Bonds, expired on December 31, 2010. Because bonds can have repayment terms of several years, a substantial amount of bonds issued prior to such repeal and expiration, as applicable, remain outstanding.

Tax-credit bonds provide tax credits to investors to replace a prescribed portion of the interest cost. The borrowing subsidy generally is measured by reference to the credit rate set by the Treasury Department. An issuer could elect to issue certain tax credit bonds as “direct-pay bonds.” Instead of a credit to the holder, for a “direct-pay bond” the Federal government pays the issuer a percentage of the interest on the bonds.

Qualified tax credit bonds (prior law)

In lieu of interest, holders of qualified tax credit bonds receive a tax credit that accrues quarterly. The following bonds are qualified tax credit bonds: qualified forestry conservation bonds, new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds.⁹ Section 54A of the Code sets forth general rules applicable to qualified tax credit bonds.

A taxpayer who holds a qualified tax credit bond on one or more credit allowance dates of the bond during the taxable year is allowed a credit against the taxpayer’s income tax for the taxable year. The annual credit is determined by multiplying the applicable credit rate by the outstanding face amount of the bond. The applicable credit rate for the bond is the rate that the Secretary estimates will permit the issuance of the qualified tax credit bond with a specified maturity or redemption date without discount and without interest cost to the qualified issuer. The Secretary determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary

⁷ Pub. L. No. 111-5, February 17, 2009.

⁸ Pub. L. No. 115-97, December 22, 2017.

⁹ See secs. 54B, 54C, 54D, 54E, and 54F (as in effect prior to repeal by sec. 13404(a) of Pub. L. No. 115-97).

deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings.

The Hiring Incentives to Restore Employment Act added section 6431(f) to the Code authorizing the issuance of certain qualified tax credit bonds as direct pay bonds.¹⁰

Build America Bonds (prior law)

The Build America Bonds program provides a subsidy to State and local governments to finance capital projects, including the development of infrastructure. Under the program, an issuer could elect to have an otherwise tax-exempt bond (other than a private activity bond), issued prior to January 1, 2011, treated as a “Build America Bond.”¹¹ In general, Build America Bonds are taxable governmental bonds the interest on which is subsidized by the Federal government by means of a tax credit to the holder (“tax-credit Build America Bonds”) or, in the case of certain qualified bonds, a direct payment to the issuer (“direct-pay Build America Bonds”).¹²

Unlike the tax credit for bonds issued under section 54A, the credit rate for tax-credit Build America Bonds is not calculated by the Secretary, but rather is set by law at 35 percent. The actual credit that a taxpayer may claim is determined by multiplying the interest payment that the taxpayer receives from the issuer (*i.e.*, the bond coupon payment) by 35 percent.¹³

In lieu of the tax credit to the holder, the issuer of a direct-pay Build America Bond is allowed a refundable credit equal to 35 percent of each interest payment made under such bond.¹⁴ Although the authority existed to issue tax-credit Build America Bonds, most Build America Bonds were issued as direct-pay Build America Bonds.

Sequestration and direct pay bonds

Pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, sequestration applies to qualified tax credit bonds and Build America Bonds issued as

¹⁰ Pub. L. No. 111-147, sec. 301, March 18, 2010.

¹¹ Sec. 54AA (as in effect prior to its repeal by sec. 13404(a) of Pub. L. No. 115-97).

¹² Tax-credit Build America Bonds could be issued to finance any governmental purpose for which tax-exempt governmental bonds (excluding private activity bonds under section 141) could be issued under section 103. The eligible uses of proceeds and types of financings for direct-pay Build America Bonds are more limited than for tax-credit Build America Bonds. Direct-pay Build America Bonds could be issued to finance only capital expenditures that could have been financed with tax-exempt governmental bonds.

¹³ Original issue discount (“OID”) is not treated as a payment of interest for purposes of determining the tax credit to the taxpayer under the provision.

¹⁴ Sec. 54AA(g)(1) (as in effect prior to its repeal by sec. 13404(a) of Pub. L. No. 115-97). OID is not treated as a payment of interest for purposes of calculating the refundable credit to the bond issuer under the provision.

direct pay bonds. For such bonds, refund payments and refund offset transactions processed are subject to a percentage reduction (5.7 percent for fiscal year 2021).¹⁵

Description of Proposal

In general

The proposal creates a new direct pay bond called a “qualified infrastructure bond.” Under the proposal, an issuer may elect to have an otherwise tax-exempt bond treated as a qualified infrastructure bond, subject to satisfaction of additional requirements. A “qualified infrastructure bond” is any obligation (other than a private activity bond) if the interest on such obligation would be (but for the bond being a qualified infrastructure bond) excludable from gross income under section 103, the issuer makes an irrevocable election to have the provision apply, and the additional requirements are satisfied. In determining if an obligation would be tax-exempt under section 103, the credit allowed to the issuer (discussed below) is not treated as a Federal guarantee. For arbitrage purposes, the yield on a qualified infrastructure bond is reduced by the credit allowed to the issuer (the reduction does not apply in determining the amount of gross proceeds of an issue that qualifies as a reasonably required reserve or replacement fund). A qualified infrastructure bond does not include any bond if the issue price has more than a de minimis amount of premium over the stated principal amount of the bond.

Taxable interest and credit payment to issuer

The interest on a qualified infrastructure bond is taxable to the bondholder and the issuer of the bond is allowed a credit equal to the applicable percentage of each interest payment made under such bond, subject to the limitation on the applicable percentage discussed below.¹⁶ The applicable percentage for a qualified infrastructure bond (other than current refunding bonds, as discussed below) depends on the calendar year in which the bond is issued as follows:

2022 through 2024	35 percent
2025	32 percent
2026	30 percent
2027 and thereafter (and current refunding bonds).....	28 percent

For example, if an issuer of a qualified infrastructure bond issued in 2022 pays a \$1,000 coupon payment, unless the limitation described in the following paragraph applies, the taxpayer who holds such a bond would include \$1,000 of interest in their income and the issuer would receive a payment of 35 percent of each \$1,000 coupon paid to bondholders. (The net interest cost to the issuer would be \$650.) The payment by the Secretary to the issuer is to be made contemporaneously with the interest payment made by the issuer and may be made either in

¹⁵ Additional information, including a summary of prior-year sequestration reduction rates, is available on the IRS’s website, at <https://www.irs.gov/tax-exempt-bonds/effect-of-sequestration-on-state-local-government-filers-of-form-8038-cp>.

¹⁶ OID is not treated as a payment of interest for purposes of calculating the refundable credit under the provision. OID is the excess of an obligation’s stated redemption price at maturity over the obligation’s issue price (sec. 1273(a)).

advance or as reimbursement. In lieu of payment to the issuer, the payment may (at the direction of the issuer) be made to a person making interest payments on behalf of the issuer.

For purposes of calculating the credit allowed with respect to a payment of interest on a qualified infrastructure bond, the amount of any interest payment taken into account with respect to a bond for any payment date shall not exceed the amount of interest which would have been payable under such bond for such payment date if interest were determined at the applicable credit rate multiplied by the applicable amount for such bond for such payment date.¹⁷

The “applicable credit rate” is the rate which the Secretary estimates will permit the issuance of qualified infrastructure bonds with a specified maturity or redemption date without discount and without additional interest cost to the issuer.¹⁸ The Secretary determines credit rates for qualified infrastructure bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The applicable credit rate with respect to any qualified infrastructure bond shall be determined as of the first day on which there is a binding, written contract for the sale or exchange of the bond.

The “applicable amount” for a bond for any payment date is (i) in the case of any bond that has more than a de minimis amount of original issue discount (determined under the rules of section 1273(a)(3)), the issue price of such bond (within the meaning of section 148), as adjusted for any principal payments made prior to such date, and (ii) in the case of any other bond, the outstanding principal amount of such bond on such payment date (determined without taking into account any principal payment on such bond on such date).

Regarding sequestration, the proposal would provide that in the case of any payment of the credit to or at the direction of the issuer of a qualified infrastructure bond to which sequestration applies, the amount of such payment is increased to an amount equal to (1) such payment (determined before such sequestration), multiplied by (2) the quotient obtained by dividing 1 by the amount by which 1 exceeds the percentage reduction in such payment pursuant to such sequestration. For these purposes, the term “sequestration” means any reduction in direct spending ordered in accordance with a sequestration report prepared by the Director of the Office and Management and Budget pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985 or the Statutory Pay-As-You-Go Act of 2010. TCJA repealed the authority to issue certain direct pay bonds after December 31, 2017, and the authority to issue other direct pay bonds expired on December 31, 2010; however, bonds can have repayment terms of several

¹⁷ For example, if an issuer of a qualified infrastructure bond issued in 2022 in a principal amount of \$20,000 (with no premium or discount) and an interest rate of 10 percent per annum pays a \$1,000 semiannual coupon payment and the applicable credit rate for such bond is 8 percent per annum, the taxpayer who holds such a bond would include \$1,000 of interest in their income and the issuer would receive a payment of 35 percent of an \$800 portion (the 8 percent per annum applicable credit rate multiplied by \$20,000, the applicable amount for the bond) of the \$1,000 coupon paid to the bondholders. The net interest cost to the issuer would be \$720.

¹⁸ Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at a par.

years, and direct pay bonds issued prior to such repeal or expiration, as applicable, remain outstanding and subject to sequestration.

Additional provisions for qualified infrastructure bonds

To qualify as a “qualified infrastructure bond,” 100 percent of the excess of available project proceeds of the issue of which the bond is a part over the amounts in a reasonably required reserve (within the meaning of section 150(a)(3)) with respect to such issue must be used for (i) capital expenditures or operations and maintenance expenditures in connection with property the acquisition, construction, or improvement of which would be a capital expenditure, or (ii) payments made by a State or political subdivision of a State to a custodian of a rail corridor for purposes of the transfer, lease, sale, or acquisition of an established railroad right-of-way consistent with section 8(d) of the National Trails Act of 1968, but only if the Surface Transportation Board has issued a certificate of interim trail use or notice of interim trail use for purposes of authorizing such transfer, lease, sale, or acquisition.

The term “available project proceeds” means (A) the excess of (i) the proceeds from the sale of an issue, over (ii) issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds) and (B) the proceeds from any investment of such excess.

A bond issued to currently refund a qualified infrastructure bond is not a qualified infrastructure bond unless (i) the average maturity date (determined in accordance with section 147(b)(2)(A)) of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue, (ii) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, (iii) the refunded bond is redeemed not later than 90 days after the date of the issuance of the refunding bond, and (iv) the refunded bond was issued more than 30 days after the date of the enactment. The applicable percentage with respect to any qualified infrastructure bond issued to currently refund another qualified infrastructure bond is 28 percent. Another section of the proposal provides authority for certain advance refunding bonds (when the refunded bond is redeemed more than 90 days after the date of issuance of the refunding bond) to be issued as tax-exempt bonds, subject to applicable requirements. Bonds issued to advance refund qualified infrastructure bonds are not qualified infrastructure bonds.

The requirements of the Davis-Bacon Act in Subchapter IV of chapter 31 of title 40, United States Code apply to projects financed with the proceeds of qualified infrastructure bonds.

Effective Date

The proposal is effective for bonds issued after December 31, 2021.

2. Advance refunding bonds

Present Law

Section 103 generally provides that gross income does not include interest received on State or local bonds. State and local bonds are classified generally as either governmental bonds

or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or that are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals).¹⁹ Bonds issued to finance the activities of charitable organizations described in section 501(c)(3) (qualified 501(c)(3) bonds”) are one type of private activity bond. The exclusion from income for interest on State and local bonds only applies if certain Code requirements are met.

The exclusion from income for interest on State and local bonds applies to refunding bonds subject to certain limits. A refunding bond is defined as any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond). Different rules apply to current refunding bonds as opposed to advance refunding bonds.

A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bond. There is no statutory limitation on the number of times that tax-exempt bonds may be currently refunded.

A bond is classified as an advance refunding if it is issued more than 90 days before the redemption of the refunded bond.²⁰ Proceeds of advance refunding bonds are generally invested in an escrow account and held until a future date when the refunded bond may be redeemed. The primary Federal tax policy concern with advance refundings is that (when permitted on a tax-exempt basis) they result in two issues of tax-exempt bonds outstanding simultaneously for more than 90 days to finance the same project or activity and thereby result in increased Federal revenue cost. Prior to An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, also known as the Tax Cuts and Jobs Act of 2017 (“TCJA”),²¹ the exclusion from gross income for State and local bonds applied, in certain limited circumstances, to advance refundings. For example, governmental bonds and qualified 501(c)(3) bonds generally could be advance refunded one time,²² while private activity bonds other than qualified 501(c)(3) bonds could not be advance refunded at all.²³ Furthermore, in the case of an advance refunding bond that resulted in interest savings (*e.g.*, a high interest rate to low interest rate refunding), the refunded bond was required to be redeemed on the first call date 90 days after the issuance of the refunding bond that resulted in debt service savings.²⁴ TCJA amended section 149 to repeal the exclusion from gross income for interest on a bond

¹⁹ Sec. 141.

²⁰ Sec. 149(d)(2).

²¹ Pub. L. No. 115-97, December 22, 2017.

²² Sec. 149(d)(3)(as in effect prior to Public Law 115-97).

²³ Sec. 149(d)(2)(as in effect prior to Public Law 115-97).

²⁴ Sec. 149(d)(3)(A)(iii) and (B) (as in effect prior to Public Law 115-97); Treas. Reg. sec. 1.149(d)-1(f)(3). A “call” provision provides the issuer of a bond with the right to redeem the bond prior to the stated maturity.

issued to advance refund another tax-exempt bond, effective for refunding bonds issued after December 31, 2017.

Description of Proposal

The proposal amends section 149 of the Code to allow the exclusion from gross income for interest on a bond issued to advance refund another tax-exempt bond, subject to limitations similar to those applicable to tax-exempt advance refunding bonds issued prior December 31, 2017.

Effective Date

The proposal is effective for advance refunding bonds issued more than 30 days after the date of enactment.

3. Permanent modification of small issuer exception to tax-exempt interest expense allocation rules for financial institutions

Present Law

Present law disallows a deduction for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is exempt from tax.²⁵

In the case of a financial institution, the Code generally disallows a deduction for that portion of the taxpayer's interest expense that is allocable to tax-exempt interest.²⁶ The amount of interest that is disallowed is an amount which bears the same ratio to such interest expense as the taxpayer's average adjusted bases of tax-exempt obligations acquired after August 7, 1986, bears to the average adjusted bases for all assets of the taxpayer.

The general rule in section 265(b), denying financial institutions' interest expense deductions allocable to tax-exempt obligations, does not apply to "qualified tax-exempt obligations."²⁷ Instead, as discussed below, only 20 percent of the interest expense allocable to "qualified tax-exempt obligations" is disallowed.²⁸ A "qualified tax-exempt obligation" is a tax-exempt obligation that (1) is issued after August 7, 1986, by a qualified small issuer, (2) is not a private activity bond, and (3) is designated by the issuer as qualifying for the exception from the general rule of section 265(b). For purposes of the definition of qualified tax-exempt obligation, qualified bonds issued to finance the activities of charitable organizations described in section

²⁵ Sec. 265(a).

²⁶ Sec. 265(b)(1). A "financial institution" is any person that (1) accepts deposits from the public in the ordinary course of such person's trade or business and is subject to Federal or State supervision as a financial institution, or (2) is a corporation described in section 585(a)(2). Sec. 265(b)(5).

²⁷ Sec. 265(b)(3).

²⁸ Secs. 265(b)(3)(A), 291(a)(3) and 291(e)(1).

501(c)(3) ("qualified 501(c)(3) bonds") and refunding bonds issued to refund certain obligations issued before August 8, 1986 are not treated as private activity bonds.

A "qualified small issuer" is an issuer that reasonably anticipates that the amount of tax-exempt obligations that it will issue during the calendar year will be \$10 million or less.²⁹ The Code specifies the circumstances under which an issuer and all subordinate entities are aggregated.³⁰ For purposes of the \$10 million limitation, an issuer and all entities that issue obligations on behalf of such issuer are treated as one issuer, and all obligations issued by a subordinate entity are treated as being issued by the entity to which it is subordinate. An entity formed (or availed of) to avoid the \$10 million limitation and all entities benefiting from the device are treated as one issuer.

Generally, composite issues (*i.e.*, combined issues of bonds for different entities) qualify for the "qualified tax-exempt obligation" exception only if the requirements of the exception are met with respect to (1) the composite issue as a whole (determined by treating the composite issue as a single issue), and (2) each separate lot of obligations that is part of the issue (determined by treating each separate lot of obligations as a separate issue).³¹ Thus, a composite issue may qualify for the exception only if the composite issue itself does not exceed \$10 million, and if each issuer benefitting from the composite issue reasonably anticipates that it will not issue more than \$10 million of tax-exempt obligations during the calendar year, including through the composite arrangement.

Section 291(a)(3) reduces by 20 percent the amount allowable as a deduction with respect to any financial institution preference item. Financial institution preference items include interest on debt to acquire tax-exempt obligations acquired after December 31, 1982, and before August 8, 1986.³² Section 265(b)(3) treats qualified tax-exempt obligations as if they were acquired on August 7, 1986. As a result, the amount allowable as a deduction by a financial institution with respect to interest incurred to carry a qualified tax-exempt obligation is reduced by 20 percent.

The American Recovery and Reinvestment Act of 2009 made certain adjustments to section 265 for tax-exempt obligations issued during 2009 and 2010, including increasing from \$10 million to \$30 million the annual limit for qualified small issuers, treating qualified 501(c)(3) bonds as if they were issued by the 501(c)(3) organization for whose benefit they were issued (and not by the actual issuer of such bonds), and, for certain qualifying issues, applying the annual volume limitation at the borrower level (rather than at the level of the pooled financing issuer).³³

²⁹ Sec. 265(b)(3)(C).

³⁰ Sec. 265(b)(3)(E).

³¹ Sec. 265(b)(3)(F).

³² Sec. 291(e)(1).

³³ Pub. L. No. 111-5, Division B, sec. 1502, February 17, 2009.

Description of Proposal

The proposal increases from \$10 million to \$30 million the annual limit for qualified small issuers and indexes the annual limit for inflation after 2021.

For “qualified financing issues,” the proposal applies the annual volume limitation at the borrower level (rather than at the level of the pooled financing issuer). Thus, for the purpose of applying the requirements of the section 265(b)(3) qualified small issuer exception, the portion of the proceeds of a qualified financing issue that are loaned to a “qualified borrower” that participates in the issue are treated as a separate issue with respect to which the qualified borrower is deemed to be the issuer.

A “qualified financing issue” is any composite, pooled or other conduit financing issue the proceeds of which are used directly or indirectly to make or finance loans to one or more ultimate borrowers each of whom is a qualified borrower. A “qualified borrower” means (1) a State or political subdivision of a State, or (2) an organization described in section 501(c)(3) and exempt from tax under section 501(a). Thus, for example, a \$100 million pooled financing issue could qualify for the section 265(b)(3) exception if the proceeds of such issue were used to make four equal loans of \$25 million to four qualified borrowers. However, if (1) more than \$30 million (or such increased annual limit as may be applicable under the adjustment for inflation) was loaned to any qualified borrower, (2) any borrower were not a qualified borrower, or (3) any borrower would, if it were the issuer of a separate issue in an amount equal to the amount loaned to such borrower, fail to meet any of the other requirements of section 265(b)(3), the entire \$100 million pooled financing issue would fail to qualify for the exception.

Additionally, for purposes of determining whether an obligation is a qualified tax-exempt obligation under section 265(b)(3), the proposal would treat qualified 501(c)(3) bonds as if they were issued by the 501(c)(3) organization for whose benefit they were issued (and not by the actual issuer of such bonds).

Effective Date

The proposal is generally effective for obligations issued after the date of enactment.

4. Modifications to qualified small issue bonds

Present Law

Interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes.³⁴ Because of the income exclusion, investors generally are willing to accept a lower interest rate on tax-exempt bonds than they might otherwise accept on a taxable investment. This, in turn, lowers the borrowing costs for the beneficiaries of such financing.

³⁴ Sec. 103.

Bonds issued by State and local governments may be classified as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds unless the bonds are issued for certain permitted purposes (“qualified private activity bonds”) and other Code requirements are met.

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility, qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond. Generally, qualified private activity bonds are subject to a number of eligibility restrictions that do not apply to governmental bonds. For example, the aggregate volume of most qualified private activity bonds is restricted by annual State volume limitations (the “State volume cap”).³⁵ For calendar year 2021, the State volume cap, which is indexed for inflation, equals \$110 per resident of the State, or \$324,995,000, if greater.³⁶ Qualified small issue bonds are subject to State volume cap.

Qualified small issue bonds (commonly referred to as “industrial development bonds” or “small issue IDBs”) are tax-exempt qualified private activity bonds issued by State and local governments to finance private business manufacturing facilities (including certain directly related and ancillary facilities) or the acquisition of land and equipment by certain farmers. A manufacturing facility is any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). Manufacturing facilities include facilities that are directly related and ancillary to a manufacturing facility (as described in the previous sentence) if (1) such facilities are located on the same site as the manufacturing facility, and (2) not more than 25 percent of the net proceeds of the issue are used to provide such facilities.

Qualified small issue bonds are subject to limits on the amount of financing that may be provided, both for a single borrowing and in the aggregate. In general, no more than \$1 million of small issue bond financing may be outstanding at any time for property of a business (including related parties) located in the same municipality or county. Generally, this \$1 million limit may be increased to \$10 million if, in addition to outstanding bonds, all other capital expenditures of the business (including related parties) in the same municipality or county are counted toward the limit over a six-year period that begins three years before the issue date of the bonds and ends three years after such date. Outstanding aggregate borrowing is limited to \$40 million per borrower (including related parties) regardless of where the property is located. The Code permits up to \$10 million of capital expenditures to be disregarded, in effect increasing from \$10 million to \$20 million the maximum allowable amount of total capital expenditures by an eligible business in the same municipality or county.

³⁵ Certain private activity bonds are not subject to the State volume cap.

³⁶ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1022, November 9, 2020.

The American Recovery and Reinvestment Act of 2009 (“ARRA”) made certain temporary adjustments to section 144(a) that expanded the availability of qualified small issue bonds to facilities creating intangible property and modified the related facilities eligible for treatment as part of a manufacturing facility.³⁷ For bonds issued after the date of enactment of ARRA and before January 1, 2011, the definition of manufacturing facilities was expanded to mean any facility that is used in the manufacturing, creation, or production of tangible property or intangible property (within the meaning of section 197(d)(1)(C)(iii)). For this purpose, intangible property means any patent, copyright, formula, process, design, knowhow, format, or other similar item. This includes among other items, the creation of computer software, and intellectual property associated bio-tech and pharmaceuticals. In lieu of the directly related and ancillary test otherwise applicable (described above), a special rule for bonds issued after the date of enactment and before January 1, 2011, provides that facilities that are functionally related and subordinate to the manufacturing facility are treated as a manufacturing facility. Functionally related and subordinate facilities must be located on the same site as the manufacturing facility. Because bonds can have repayment terms of several years, a substantial amount of bonds issued under the temporary adjustment may remain outstanding.

Description of Proposal

The proposal increases the limit on qualified small issue bonds that may be outstanding at any time for property of a business (including related parties) located in the same municipality or county from \$10 million to \$30 million and indexes the limit for inflation after 2021. The issuer can elect to have this limit apply (instead of the generally applicable \$1 million limit) if, in addition to outstanding bonds, all other capital expenditures of the business (including related parties) in the same municipality or county are counted toward the limit over a six-year period that begins three years before the issue date of the bonds and ends three years after such date.

Additionally, the proposal expands the availability of qualified small issue bonds to manufacturing facilities creating intangible property and adds to the related facilities treated as part a manufacturing facility. The definition of manufacturing facility is expanded to include intangible property (within the meaning of section 197(d)(1)(C)(iii)). For this purpose, intangible property means any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item. It is intended to include among other items, the creation of computer software, and intellectual property associated bio-tech and pharmaceuticals. The proposal adds facilities that are functionally related and subordinate to a manufacturing facility as part of the manufacturing facility for purposes of eligible uses of qualified small issue bonds.³⁸ Functionally related and subordinate facilities must be located on the same site as the manufacturing facility. Directly related and ancillary facilities that are not functionally related and subordinate to a manufacturing facility are eligible for financing by qualified small issue

³⁷ Pub. L. No. 111-5, Division B, sec. 1301, February 17, 2009.

³⁸ The provision is based in part on a similar rule applicable to exempt facility bonds. Treas. Reg. sec. 1.103-8(a)(3) provides: “(3) Functionally related and subordinate. An exempt facility includes any land, building, or other property functionally related and subordinate to such facility. Property is not functionally related and subordinate to a facility if it is not of a character and size commensurate with the character and size of such facility.”

bonds if (1) such facilities are located on the same site as the manufacturing facility and (2) not more than 25 percent of the net proceeds of the issue are used to provide such directly related and ancillary facilities

The proposal includes a limitation that precludes the issuance of qualified small issue bonds to refund qualified small issue bonds (refunded bonds) issued prior to the date of enactment for manufacturing facilities for intangible property or functionally related and subordinate facilities, unless such refunded bonds financed such facilities pursuant to the temporary rule applicable pursuant to ARRA (discussed above), either directly or in a series of refundings.

Effective Date

The proposal is generally effective for obligations issued after the date of enactment.

5. Expansion of certain exceptions to the private activity bond rules for first-time farmers

Present Law

Interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes.³⁹ Because of the income exclusion, investors generally are willing to accept a lower interest rate on tax-exempt bonds than they might otherwise accept on a taxable investment. This, in turn, lowers the borrowing costs for the beneficiaries of such financing.

Bonds issued by State and local governments may be classified as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds unless the bonds are issued for certain permitted purposes ("qualified private activity bonds") and other Code requirements are met.

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility, qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond. Generally, qualified private activity bonds are subject to a number of eligibility restrictions that do not apply to governmental bonds. For example, the aggregate volume of most qualified private activity bonds is restricted by annual State volume limitations (the "State volume cap").⁴⁰ For calendar year 2021, the State volume

³⁹ Sec. 103.

⁴⁰ Certain private activity bonds are not subject to the State volume cap.

cap, which is indexed for inflation, equals \$110 per resident of the State, or \$324,995,000, if greater.⁴¹ Qualified small issue bonds are subject to State volume cap.

Qualified small issue bonds (commonly referred to as “industrial development bonds” or “small issue IDBs”) are tax-exempt qualified private activity bonds issued by State and local governments to finance private business manufacturing facilities (including certain directly related and ancillary facilities) or the acquisition of land and equipment by certain farmers.

In general, qualified private activity bonds, including qualified small issue bonds, may not be issued for the acquisition of land to be used for farming purposes⁴² or for the acquisition of used property.⁴³ Under exceptions to these general rules, qualified small issue bonds can be used for the acquisition of land and used property by first-time farmers for farming purposes, subject to certain limitations. The amount of proceeds that can be used for the acquisition of land by a first-time farmer is limited to a specified amount of \$450,000, indexed for inflation for calendar years after 2008.⁴⁴ The limit is \$558,000 for 2021.⁴⁵ Used equipment to be used for farming purposes on any land satisfying the requirements for acquisition by a first-time farmer is also eligible for a qualified small issue bond up to a limit of \$62,500. Additionally, there is a \$250,000 limit on the amount of net proceeds of a qualified small issue bond used to provide depreciable farm property.

“First-time farmer” means any individual if such individual (including their spouse and minor children) has not at any time had any direct or indirect ownership interest in substantial farmland in the operation of which such individual materially participated and has not received financing under the exception permitting the acquisition of land by a first-time farmer in an amount which, when added to the financing to be provided, exceeds the applicable annual limit (\$558,000 for calendar year 2021).⁴⁶ “Substantial farmland” means any parcel of land unless such parcel is smaller than 30 percent of the median size of a farm in the county in which such parcel is located.⁴⁷

Description of Proposal

The proposal increases the dollar limitations applicable to the use of qualified small issue bonds for the acquisition of land to be used for farming purposes, prior to indexing for inflation, from \$450,000 (which was increased after indexing for inflation in calendar year 2021 to

⁴¹ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1022, November 9, 2020.

⁴² Sec. 147(c)(1)(B).

⁴³ Sec. 147(d).

⁴⁴ Sec. 147(c)(2).

⁴⁵ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1022, November 9, 2020.

⁴⁶ Sec. 147(c)(2)(C).

⁴⁷ Sec. 147(c)(2)(E).

\$558,000) to \$552,500 for bonds issued after the date of enactment and in calendar year 2021, and indexes such limit for inflation after 2021. The proposal eliminates the lower dollar limitation on used farm equipment, increases the dollar limitation on acquisition of depreciable farm property from \$250,000 to \$552,500, and indexes such limit for inflation after 2021. Additionally, for purposes of determining if an individual is a first time farmer, the 30 percent size limit used to determine if a parcel of land is substantial farmland will be based on the average, rather than the median, size of a farm in the county in which such parcel is located.

Effective Date

The proposal is effective for bonds issued after the date of enactment.

6. Certain water and sewage facility bonds exempt from volume cap on private activity bonds

Present Law

Interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes.⁴⁸ Because of the income exclusion, investors generally are willing to accept a lower interest rate on tax-exempt bonds than they might otherwise accept on a taxable investment. This, in turn, lowers the borrowing costs for the beneficiaries of such financing.

Bonds issued by State and local governments may be classified as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental functions or which are repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for interest paid on State and local bonds does not apply to private activity bonds unless the bonds are issued for certain permitted purposes (“qualified private activity bonds”) and other Code requirements are met.

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility, qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.

Exempt facility bonds are often used to finance infrastructure projects. To qualify as an exempt facility bond, 95 percent of the net proceeds must be used to finance an eligible facility. Facilities eligible include, among others, facilities for the furnishing of water and sewage facilities⁴⁹ that, generally, may be privately owned. A facility for the furnishing of water must meet the following two requirements: (1) the water is or will be made available to the public (including electric utility, industrial, agricultural, or commercial users); and (2) either the facility

⁴⁸ Sec. 103.

⁴⁹ Sec. 142(a).

is operated by a governmental unit or the rates for the furnishing or sale of the water have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

Generally, qualified private activity bonds are subject to a number of eligibility restrictions that do not apply to governmental bonds. For example, the aggregate volume of most qualified private activity bonds is restricted by annual State volume limitations (the “State volume cap”).⁵⁰ For calendar year 2021, the State volume cap, which is indexed for inflation, equals \$110 per resident of the State, or \$324,995,000, if greater.⁵¹

Exempt facility bonds issued to provide facilities for the furnishing of water and sewage facilities are subject to the State volume cap requirement.

Description of Proposal

The proposal provides an exception to the State volume cap requirement for exempt facility bonds issued to provide facilities for the furnishing of water and sewage facilities if 95 percent or more of the net proceeds of the bonds are used to provide facilities which will be used (i) by a person who was, as of July 1, 2020, engaged in operation of a facility of the type provided, and (ii) to provide service within the area served by such person on such date (or within a county or city any portion of which is within such area), or by a successor in interest to such person for the same use and within the same service area.

Effective Date

The proposal is effective for bonds issued after the date of enactment.

7. Exempt facility bonds for zero-emission vehicle infrastructure

Present Law

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity

⁵⁰ The following private activity bonds are not subject to the State volume cap: qualified 501(c)(3) bonds, exempt facility bonds for airports, docks and wharves, environmental enhancements for hydroelectric generating facilities, and exempt facility bonds for solid waste disposal facilities that are to be owned by a governmental unit. The State volume cap does not apply to 75 percent of exempt facility bonds issued for high-speed intercity rail facilities (100 percent if the high-speed intercity rail facility is to be owned by a governmental unit). Qualified veterans mortgage bonds and exempt facility bonds for qualified public educational facilities, qualified green building and sustainable design projects, and qualified highway or surface freight transfer facilities also are not subject to the State volume cap, but the Code subjects such bonds to volume limitations specific to the category of bonds.

⁵¹ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1022, November 9, 2020.

bond includes an exempt facility, qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.⁵²

Exempt facility bonds are often used to finance infrastructure projects. To qualify as an exempt facility bond, 95 percent of the net proceeds must be used to finance an eligible facility.⁵³ Facilities eligible for this financing include the following:

- Airports,
- Ports (docks and wharves),
- Mass commuting facilities,
- Facilities for the furnishing of water,
- Sewage facilities,
- Solid waste disposal facilities,
- Qualified residential rental projects,
- Facilities for the local furnishing of electric energy or gas,
- Local district heating or cooling facilities,
- Qualified hazardous waste facilities,
- High-speed intercity rail facilities,
- Environmental enhancements of hydro-electric generating facilities,
- Qualified public educational facilities,
- Qualified green building and sustainable design projects, and
- Qualified highway or surface freight transfer facilities.⁵⁴

Generally, qualified private activity bonds are subject to a number of eligibility restrictions that do not apply to governmental bonds. For example, the aggregate volume of most qualified private activity bonds is restricted by annual State volume limitations (the “State

⁵² Sec. 141(e).

⁵³ Sec. 142(a).

⁵⁴ Sec. 142(a)(1)-(15).

volume cap”).⁵⁵ For calendar year 2021, the State volume cap, which is indexed for inflation, equals \$110 per resident of the State, or \$324,995,000, if greater.⁵⁶

Description of Proposal

The proposal adds a new category of exempt facility bonds for zero-emission vehicle infrastructure.

“Zero-emission vehicle infrastructure” means any property (not including a building and its structural components) if such property is part of a unit which is used to charge or fuel zero-emissions vehicles, is located where the vehicles are charged or fueled, is of a character subject to the allowance for depreciation (or amortization in lieu of depreciation), is made available for use by members of the general public, accepts payment via a credit card reader (including a credit card reader that uses contactless technology), and is capable of charging or fueling vehicles produced by more than one manufacturer (within the meaning of section 30D(d)(3)). For property which is part of a unit which is used exclusively by fleets of commercial or governmental vehicles, the last three requirements listed do not apply. “Zero-emission vehicle infrastructure” also includes any utility service connections, utility panel upgrades, line extensions and conduit, transformer upgrades, or similar property, in connection with property meeting the applicable requirements.

The term “zero-emissions vehicle” means either a zero-emission vehicle as defined in section 88.102–94 of title 40, Code of Federal Regulations, or a vehicle that produces zero exhaust emissions of any criteria pollutant (or precursor pollutant) or greenhouse gas under any possible operational modes and conditions.

Any zero-emission vehicle infrastructure located within another type of facility or project eligible for financing by exempt facility bonds, or an area adjacent to such a facility or project that primarily serves vehicles traveling to or from such facility or project, is treated as that type of facility or project for purposes of eligibility restrictions applicable to exempt facility bonds.

Except to the extent not applicable due to the treatment described in the preceding paragraph, the State volume cap applies to exempt facility bonds issued for zero-emission vehicle infrastructure.

⁵⁵ The following private activity bonds are not subject to the State volume cap: qualified 501(c)(3) bonds, exempt facility bonds for airports, docks and wharves, environmental enhancements for hydroelectric generating facilities, and exempt facility bonds for solid waste disposal facilities that are to be owned by a governmental unit. The State volume cap does not apply to 75 percent of exempt facility bonds issued for high-speed intercity rail facilities (100 percent if the high-speed intercity rail facility is to be owned by a governmental unit). Qualified veterans mortgage bonds and exempt facility bonds for qualified public educational facilities, qualified green building and sustainable design projects, and qualified highway or surface freight transfer facilities also are not subject to the State volume cap, but the Code subjects such bonds to volume limitations specific to the category of bonds.

⁵⁶ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1022, November 9, 2020.

Effective Date

The proposal is effective for obligations issued after December 31, 2021.

8. Application of Davis-Bacon Act requirements with respect to certain exempt facility bonds

Present Law

Qualified private activity bonds are tax-exempt private activity bonds issued to provide financing for specified privately used facilities. The definition of a qualified private activity bond includes an exempt facility, qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.⁵⁷

Exempt facility bonds are often used to finance infrastructure projects. To qualify as an exempt facility bond, 95 percent of the net proceeds must be used to finance an eligible facility.⁵⁸ Facilities eligible for this financing include the following:

- Airports,
- Ports (docks and wharves),
- Mass commuting facilities,
- Facilities for the furnishing of water,
- Sewage facilities,
- Solid waste disposal facilities,
- Qualified residential rental projects,
- Facilities for the local furnishing of electric energy or gas,
- Local district heating or cooling facilities,
- Qualified hazardous waste facilities,
- High-speed intercity rail facilities,
- Environmental enhancements of hydro-electric generating facilities,
- Qualified public educational facilities,
- Qualified green building and sustainable design projects, and
- Qualified highway or surface freight transfer facilities.⁵⁹

⁵⁷ Sec. 141(e).

⁵⁸ Sec. 142(a).

⁵⁹ Sec. 142(a)(1)-(15).

Generally, qualified private activity bonds are subject to a number of eligibility restrictions that do not apply to governmental bonds. For example, the aggregate volume of most qualified private activity bonds is restricted by annual State volume limitations (the “State volume cap”). For calendar year 2021, the State volume cap, which is indexed for inflation, equals \$110 per resident of the State, or \$324,995,000, if greater.⁶⁰

Description of Proposal

The proposal adds a new requirement for exempt facility bonds issued to provide facilities for the furnishing of water, sewage facilities, and qualified highway or surface freight transfer facilities, and for such bonds issued to provide zero-emission vehicle infrastructure under another section of this proposal. These facilities would only be eligible for financing with exempt facility bonds if each entity that receives bond proceeds to conduct construction, alteration, or repair of such facilities agrees to comply with the provisions of subchapter IV of chapter 31 of title 40, United States Code with respect to such construction, alteration, or repair.

Effective Date

The proposal is effective for bonds issued after the date of enactment.

⁶⁰ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1022, November 9, 2020.

B. Credit for Operations and Maintenance Costs of Government-Owned Broadband

Present Law

While certain broadband property may qualify for some general tax incentives,⁶¹ no broadband specific tax incentives exist in the Code.

Description of Proposal

In general

Under the proposal, a new credit is provided for the applicable percentage of qualified broadband expenses paid or incurred by an eligible government entity. The Secretary shall pay the credit to an eligible governmental entity upon receipt of information as the Secretary may require.

Credit amount

The applicable percentage is 30 percent in taxable years beginning in 2021 through 2026, 26 percent in taxable years beginning in 2027, and 24 percent in taxable years beginning in 2028.

Qualified broadband expenses for purposes of the credit may not exceed \$400 times the number of qualified households subscribed to the relevant qualified broadband service determined at any time during the taxable year.

Eligible government entities and qualified households

Eligible government entities are any State, local, or Indian tribal government, any political subdivision or instrumentality of such a government, or any entity wholly owned by one or more government or political subdivision or instrumentality thereof.⁶² The taxable year for an eligible governmental entity means the fiscal year of the eligible governmental entity.

A qualified household is a personal residence located in a low-income community⁶³ that did not have access to qualified broadband service from the eligible governmental entity as of the beginning of the taxable year of the entity.

⁶¹ Certain broadband related property may be eligible for accelerated depreciation under section 168. The IRS has issued several safe harbors on the recovery of various costs and assets used in providing broadband service. For examples, see Rev. Proc. 2015-12, 2015-2 I.R.B. 266, Rev. Proc. 2011-28, 2011-18 I.R.B. 743, Rev. Proc. 2011-27, 2011-18 I.R.B. 740, and Rev. Proc. 2011-22, 2011-18 I.R.B. 737.

⁶² For this purpose, State includes any possession of the United States.

⁶³ Under the meaning of section 45D(e).

Qualified broadband

Qualified broadband expenses are amounts paid or incurred for the operation and maintenance of a qualified broadband network that are properly allocable to qualified households subscribed to the qualified broadband service provided by the network. A qualified broadband network is property owned by an eligible governmental entity used for the purpose of providing qualified broadband service. Qualified broadband service is fixed, terrestrial broadband service providing downloads (uploads) at a speed of at least 25 (three) megabits per second. Amounts properly allocated are allocated ratably among subscribers to the qualified broadband service. Qualified broadband expenses do not include any amount paid or reimbursed by any Federal grant.

Credit termination

No credit is allowed for any taxable year beginning after December 31, 2028.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2020.

C. Permanent Extension of New Markets Tax Credit

Present Law

In general

The New Markets Tax Credit (“NMTC”) is a geography-based tax credit program. Under section 45D(a), an investor may claim tax credits for a qualified equity investment in a qualified community development entity (“CDE”). The qualified CDE designates equity investments as qualified equity investments, rendering the investor eligible to receive tax credits. The qualified CDE can only designate up to an amount allocated to it by the Department of the Treasury’s Community Development Financial Institutions Fund (“CDFI Fund”). The CDFI Fund allocates amounts to qualified CDEs through a competitive application process.

The amount of the NMTC is determined on a credit allowance date as an amount equal to the applicable percentage of the qualified equity investment in the qualified CDE on that date. The applicable percentage is five percent for the first three years of the investment and six percent for the remaining four years, for a total credit of 39 percent over seven years. The credit allowance date is the date of the investment and the next six anniversary dates of the investment.

To continue to be eligible for tax credits, the taxpayer must continue to hold the qualified equity investment on the credit allowance date of each year. In other words, if the qualified equity investment ceases, or ceases to be qualified, the remaining tax credits are no longer allowed. The credits already claimed may also be subject to recapture if the CDE ceases to be qualified, if the proceeds of the investment cease to be used in a qualified manner, or if the taxpayer redeems its qualified equity investment.

Regulated financial institutions provide most of the equity for NMTC transactions. In addition to receiving the NMTC, financial institutions often receive credit under the Community Reinvestment Act for investing in low-income census tracts.

Substantially all of the qualified equity investment must be used by the qualified CDE to provide investments in low-income communities through qualified active low-income community businesses.

Qualifying geography

The NMTC provisions require CDEs to serve or provide investment capital for low-income communities or low-income persons. A low-income community is either (1) a population census tract that meets certain criteria, or (2) a specific area designated by the Secretary. Specifically, a “low-income community” is a population census tract with either (1) a poverty rate of at least 20 percent, or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a nonmetropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net

out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the NMTC if such tract is within an empowerment zone (the designation of which is in effect under section 1391) and is contiguous to one or more low-income communities.

CDEs may also qualify for the NMTC if they serve targeted populations, as designated by the Secretary, regardless of the composition of the population census tract or tracts in which the targeted populations live. Under this rule, the targeted population is treated as a low-income census tract. For this purpose, a “targeted population” is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (the “Act”) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that “low-income” means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a nonmetropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide nonmetropolitan area median family income.

Project structures

In a typical NMTC structure, an intermediary entity (the “investment fund LLC”) receives equity investments from investors (usually financial institutions) and debt from other sources. The investment fund LLC’s proceeds are then invested as equity investment into a qualified CDE. The qualified CDE in turn makes a qualified low-income community investment in a qualified active low-income community business.

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE. A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a CDE for cash and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder. Substantially all the investment proceeds must be used by the CDE to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified low-income community businesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.

Although equity investments in qualified active low-income community businesses qualify under the NMTC rules, generally, such investments are in the form of loans. Equity investors that own a majority interest in a low-income community business can have their NMTC credits recaptured if the business violates the rules for qualification. However, Treasury regulations provide a “reasonable expectation” safe harbor for CDEs that lend to such a business;

if the CDE “reasonably expects” that the rules are being satisfied, NMTC credits are not subject to recapture.⁶⁴

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of such business is used in a low-income community; (3) a substantial portion of the services performed for such business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of such business is attributable to certain financial property or to certain collectibles. A business which operates a racetrack or other gambling facility cannot meet the definition of a qualified business and is therefore ineligible to receive allocations from the CDFI Fund.⁶⁵

Allocation process

The CDFI Fund annually allocates NMTCs to CDEs under a competitive application process. CDEs, in turn, allocate NMTCs to equity investors. The maximum annual amount of NMTCs that the CDFI Fund can allocate is \$3.5 billion for calendar years 2010 through 2019 and \$5 billion for calendar years from 2020 through 2025. No amount of unused allocation limitation may be carried to any calendar year after 2030.⁶⁶

For the 2020 allocation application round, the CDFI Fund awarded 100 CDEs \$5.0 billion in NMTCs from a total of 208 applications requesting \$15.1 billion.⁶⁷ Out of the total awarded, approximately \$3.8 billion (78 percent) of NMTC investment proceeds will likely be

⁶⁴ Treas. Reg. sec. 1.45D-1(d)(6)(i).

⁶⁵ Treas. Reg. sec. 1.45D-1(d)(5)(iii)(B).

⁶⁶ A total of \$66 billion of credits had been allocated as of September 2021. As originally enacted in 2000, \$15 billion was authorized for the new markets tax credit program through 2007. Consolidated Appropriations Act, 2001, Pub. L. No. 106-554, sec. 121, December 21, 2000. In 2005, an additional \$1 billion of credits was authorized for qualified areas affected by Hurricane Katrina over a period of three years. Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135, sec. 101, December 21, 2005. In 2006 and again in 2008, another \$3.5 billion was authorized. Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, sec. 102, December 20, 2006, and the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, sec. 302, October 3, 2008. In 2009, the allocation amount was increased for 2008 and 2009 from \$3.5 billion to \$5 billion. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, sec. 1403, February 17, 2009. In 2010, an additional 3.5 billion was allocated for 2010 and 2011. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, sec. 733, December 17, 2010. In 2013, an additional \$3.5 billion was allocated for 2012 and 2013. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, sec. 305, January 2, 2013. In 2014, an additional \$3.5 billion was allocated for 2014. Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, sec. 115, December 19, 2014. In 2015, an additional \$3.5 billion was allocated for five years through 2019. Protecting Americans From Tax Hikes (“PATH”) Act, Division Q of Pub. L. No. 114-113, sec. 141, December 18, 2015. In 2019, an additional \$5 billion was allocated for 2020. Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94, sec. 141, December 20, 2019. In 2020, an additional \$5 billion was allocated for five years through 2025. Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, sec. 112, December 27, 2020.

⁶⁷ Information is available at <https://home.treasury.gov/news/press-releases/jy0340> (last visited September 10, 2021).

used to finance and support loans to or investments in operating businesses in low-income communities, and approximately \$1.1 billion (22 percent) of NMTC investment proceeds will likely be used to finance and support real estate projects in low-income communities.⁶⁸

Applications for NMTCs are reviewed in two phases.⁶⁹ In Phase 1, applications are reviewed, scored, and ranked based on two criteria: business strategy and community outcomes. Applicants that meet the minimum scoring thresholds in Phase 1 advance to Phase 2 review and will be provided with “preliminary” awards, in descending order of final rank score, until the available allocation authority is fulfilled. Final rank scores are determined by evaluating management capacity, capitalization strategy, and information regarding previous awards.⁷⁰

In Phase 1, in evaluating and scoring the business strategy criteria, the CDFI Fund is looking for a CDE to articulate, with specificity, its strategy to use an allocation and to describe a long track record serving low-income communities, and of providing products and services like those that it intends to provide through its investments. The CDE can earn “priority points” if it has a track record of five or more years of experience providing capital and/or technical assistance to disadvantaged businesses and communities. For the community outcomes criteria, the CDFI Fund considers the extent to which the CDE is working in particularly economically distressed or otherwise underserved communities, shows that its projected financing activities will generate demonstrable community outcomes, and demonstrates meaningful engagement with community stakeholders when vetting potential investments. In general, the highest ranked applications provide specifics concerning job creation, community development benefits, and a track record of providing capital and/or technical assistance to disadvantaged businesses and communities.

In Phase 2, management capacity is evaluated based on management experience in low-income communities, asset and risk management, and fulfilling government compliance requirements. Capitalization is evaluated based on an applicant’s track record of raising capital, investor commitments (or a strategy to secure such commitments), plan to pass along the benefits of the credit to the underlying businesses, and willingness to invest in amounts that exceed the minimum statutory requirements. Applicants with prior year allocations are evaluated on their effective use of prior-year allocations and whether they have substantiated a need for additional allocation authority.

⁶⁸ Information is available in the 2020 NMTC Award Book. It is available at www.cdfifund.gov/sites/cdfi/files/2021-08/CY2020_NMTC_Program_Award_Book_FINAL.pdf (last visited September 10, 2021).

⁶⁹ The 2020 NMTC program allocation application provides information on reviewer criteria. It is available at https://www.cdfifund.gov/sites/cdfi/files/202104/Updated_CY_2020_NMTC_Allocation_Application_FINAL_210CT2020.pdf (last visited September 10, 2021). The term “infrastructure” is provided as a business type on page 58 of the application.

⁷⁰ Information on the allocation application review process, general characteristics of a highly ranked application, and application ratings is available at https://www.cdfifund.gov/sites/cdfi/files/2021-09/CY2020_NMTC_Application_Review_Process_26AUG2021.pdf (last visited September 10, 2021).

Alternative minimum tax

Individual alternative minimum tax

Individuals and trusts and estates may be subject to the alternative minimum tax (“AMT”), in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year.⁷¹ The tentative minimum tax is determined by reference to an alternative minimum taxable income (“AMTI”), which is the taxpayer’s taxable income increased by the taxpayer’s tax preferences and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.⁷² This amount is compared to an exemption amount that varies by filing status.⁷³

Among the tax preferences and adjustments included in AMTI are an inclusion of certain tax-exempt interest⁷⁴ and the disallowance of the deduction for State and local taxes, the standard deduction, and certain itemized deductions.⁷⁵

An individual may generally use credits against both regular tax liability and tentative minimum tax liability.⁷⁶

However, the new markets tax credit cannot be used to offset AMT liability because the general business credit (which is the sum of various business tax credits) generally may not exceed the excess of the taxpayer’s net income tax⁷⁷ over the tentative minimum tax (or, if greater, 25 percent of so much of the taxpayer’s net regular tax liability⁷⁸ as exceeds \$25,000).⁷⁹

⁷¹ Sec. 55.

⁷² Secs. 56, 57 and 58.

⁷³ For taxable years beginning in 2021, the exemption amount is \$114,600 for married individuals filing jointly and surviving spouses, \$73,600 for other unmarried individuals, and \$57,300 for married individuals filing separately. For taxable years beginning in 2021, the phase-out threshold is \$1,047,200 for married taxpayers filing a joint return, and \$523,600 for all other taxpayers (other than estates and trusts). These exemption amounts and the exemption amount phase-out thresholds were increased for taxable years beginning after December 31, 2017 and beginning before January 1, 2026, and the amounts are indexed for inflation.

⁷⁴ Sec. 57(a)(5).

⁷⁵ Sec. 56(b).

⁷⁶ See sec. 26(a).

⁷⁷ The term “net income tax” means the sum of the regular tax liability and AMT, reduced by the credits allowable under sections 21 through 30D. Sec. 38(c)(1).

⁷⁸ The term “net regular tax liability” means the regular tax liability reduced by the sum of certain nonrefundable personal and other credits. Sec. 38(c)(1).

⁷⁹ Sec. 38(c).

Any general business credit in excess of the limitation may be carried back one year and forward up to 20 years.⁸⁰

In applying the tax liability limitation to a list of “specified credits” that are part of the general business credit, the tentative minimum tax is treated as being zero.⁸¹ Thus, the specified credits generally may offset both regular tax and AMT liabilities.

Corporate alternative minimum tax

The corporate AMT was repealed for taxable years beginning after December 31, 2017.

Description of Proposal

The proposal increases the allocation amount from \$5 billion to \$7 billion for calendar year 2022 and from \$5 billion to \$6 billion for calendar year 2023. The allocation amounts for calendar years 2024 and 2025 remain \$5 billion.

The proposal also extends the new markets tax credit permanently, with a new allocation amount of \$5 billion for each calendar year after 2025. New carryover periods for unused new markets tax credits automatically follow five calendar years after each allocation year, starting in 2026. The allocation amounts are indexed for inflation after 2024.

The proposal also adds the new markets tax credit to the list of specified credits. Thus, the new markets tax credit may offset both regular tax and AMT liabilities.

Effective Date

The proposals to increase the allocation amounts, permanently extend the new markets tax credit, and index the allocation amounts are effective for calendar years after 2021.

The proposal to allow the new markets tax credit to be used to offset AMT liability is effective for qualified equity investments initially made after December 31, 2021.

⁸⁰ Sec. 39.

⁸¹ See section 38(c)(4)(B) for the list of specified credits, which does not presently include the NMTC determined under section 45D.

D. Rehabilitation Tax Credit

Present Law

A 20-percent tax credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure.⁸² A certified historic structure means any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district. The credit is generally allowable ratably in each taxable year over the five-year period beginning in the taxable year in which the qualified rehabilitated building is placed in service, for amounts paid or incurred after December 31, 2017.

The basis of the property is reduced by the amount of the rehabilitation credit.⁸³

For qualified rehabilitation expenditures to be eligible for the credit, the building must be substantially rehabilitated. A building is treated as having met the substantial rehabilitation requirement only if the rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the taxable year exceed the greater of (1) the adjusted basis of the building (and its structural components), or (2) \$5,000.⁸⁴ Taxpayers are required to use straight-line depreciation in order for rehabilitation expenditures to be treated as qualified.

Qualified rehabilitation expenditures with respect residential property generally do not include any expenditure in connection with the rehabilitation of the portion of a building that is (or expected to be) leased to a tax-exempt entity.⁸⁵ In the case of nonresidential real property, qualified rehabilitation expenditures generally do not include any expenditure in connection with the rehabilitation of a building that is more than 50 percent leased to a tax-exempt entity in a disqualified lease. In general, a disqualified lease includes a lease of tax-exempt-bond-financed property, a lease with a sale option (or its equivalent) to the tax-exempt entity, a lease with a term greater than 20 years, or a sale-leaseback arrangement involving a tax-exempt entity.⁸⁶ For this purpose, a tax-exempt entity generally includes the United States, a state or political subdivision, possession, or any agency or instrumentality of the foregoing (“governmental entity”).⁸⁷

⁸² Sec. 47.

⁸³ Sec. 50(c).

⁸⁴ Sec. 47(c)(1)(B). A special rule for phased rehabilitation substitutes a 60-month period for the 24-month period. Sec. 47(c)(1)(B)(ii).

⁸⁵ Secs. 47(c)(2)(B)(5) and 168(h).

⁸⁶ Sec. 168(h)(1)(B).

⁸⁷ Sec. 168(h)(2). Certain exceptions also apply.

Description of Proposal

The proposal makes several changes to the rehabilitation tax credit. The credit rate under the proposal is increased temporarily from 20 percent. The credit rate is increased to 30 percent in taxable years beginning in 2020 through 2025, 26 percent in taxable years beginning in 2026, and 23 percent in taxable years beginning in 2027. The credit rate reverts to 20 percent in taxable years beginning after 2027. If qualified rehabilitation expenditures with respect to a qualified rehabilitated building are incurred in taxable years with differing credit rates, the credit rate for the taxable year in which an expenditure is paid or incurred applies to that expenditure.

The proposal adds a taxpayer election to increase the credit percentage to 30 percent for certain smaller projects. The amount of qualified rehabilitation expenditures taken into account for this purpose for a qualified rehabilitated building cannot exceed \$2,500,000. A smaller project is defined generally as a qualified rehabilitated building for which the qualified rehabilitation expenditures do not exceed \$3,750,000, and for which no rehabilitation credit was allowed for the two taxable years preceding the first year for which such expenditures are paid or incurred.

The proposal modifies the substantial rehabilitation requirement so that the qualified rehabilitation expenditures must exceed the greater of (1) 50 percent (not 100 percent) of the adjusted basis of the building (and its structural components), or (2) \$5,000.

The proposal eliminates the limitation requiring reduction of the basis of the property by the amount of the rehabilitation credit.

The proposal modifies the definition of tax-exempt use property for purposes of the rehabilitation credit by limiting the relevance of a disqualified lease with respect to tax-exempt entities that are not governmental entities. Under the proposal, except in the case of a tax-exempt entity that is a governmental entity, nonresidential real property is not treated as tax-exempt use property even if a lease with respect to the property to a tax-exempt entity comes within the present-law definition of a disqualified lease. Under the proposal, rehabilitated nonresidential real property generally is tax-exempt use property if more than 50 percent of the property is leased to any tax-exempt entity that is a governmental entity.

The proposal modifies the limitation on leasing a rehabilitated building to tax-exempt entities in the case of certain public schools. Under the proposal, this limitation on certain leases does not apply in the case of rehabilitation of a building that was used as a qualified public educational facility⁸⁸ at any time during the five-year period ending with the date rehabilitation begins, and is used as such immediately after the rehabilitation. A Treasury Department report on the effects of the proposal is required within five years after the date of enactment.

Effective Date

The temporary credit rate increase is effective for property placed in service after March 31, 2021. The elective credit rate increase for smaller projects is effective for taxable years

⁸⁸ As defined in section 142(k)(1) without regard to section 142(k)(1)(B).

beginning after December 31, 2021. The modification of the substantial rehabilitation requirement is effective for 24-month (or 60-month) periods ending after December 31, 2021. The elimination of the rehabilitation credit basis adjustment is effective for property placed in service after December 31, 2022. The proposal relating to disqualified leases with tax-exempt entities (other than governmental entities) is effective for leases entered into after December 31, 2021. The proposal permitting leasing of rehabilitated public schools is effective for property placed in service after December 31, 2021.

E. Disaster and Resiliency

1. Exclusion of amounts received from State-based catastrophe loss mitigation programs

Present Law

In general

Any amount that an individual receives as a qualified disaster relief payment or that is received as a qualified disaster mitigation payment is excluded from gross income.⁸⁹

Qualified disaster relief payment

A qualified disaster relief payment is any amount paid to or for the benefit of the individual (1) to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; (2) to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for the repair, rehabilitation, or replacement is attributable to a qualified disaster; (3) by a person engaged in the furnishing or sale of transportation as a common carrier by reason of the death or personal physical injuries incurred as a result of a qualified disaster; or (4) if the amount is paid by a Federal, State, or local government, or by an agency or instrumentality of the government, in connection with a qualified disaster in order to promote the general welfare, but only to the extent that any expense compensated by the payment is not otherwise compensated by insurance or other sources.⁹⁰

A qualified disaster is a disaster that results from a terrorist or military action; a Federally declared disaster;⁹¹ a disaster that results from an accident involving a common carrier, or from any other event, that the Secretary determines is of a catastrophic nature; or, in respect of general welfare payments by a government, a disaster that by determination of an applicable Federal, State, or local authority, warrants assistance from the Federal, State, or local government (or an agency or instrumentality of the government).⁹²

Qualified disaster mitigation payment

A qualified disaster mitigation payment is any amount that is paid under the Robert T. Stafford Disaster Relief and Emergency Assistance Act or the National Flood Insurance Act to or

⁸⁹ Sec. 139(a), (g)(1).

⁹⁰ Sec. 139(b).

⁹¹ A Federally declared disaster is a disaster declared by the President to be eligible for Federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

⁹² Sec. 139(c).

for the benefit of the owner of any property for hazard mitigation with respect to the property.⁹³ The term does not include any amount received for the sale or disposition of any property.⁹⁴

Special rules

For purposes of the Code provisions for employment tax and self-employment tax, qualified disaster relief payments and qualified disaster mitigation payments are not treated as net earnings from self-employment, wages, or compensation subject to tax.⁹⁵

If with respect to any property an amount is excluded from gross income as a qualified disaster mitigation payment, no increase in the basis or adjusted basis of the property may result from the excluded amount.⁹⁶

The person for whose benefit a qualified disaster relief payment or a qualified disaster mitigation payment is made is not allowed a deduction or credit for, or by reason of, any expenditure to the extent of the amount excluded under this section with respect to the expenditure (a “no-double-benefit rule”).⁹⁷

Description of Proposal

The proposal allows an exclusion from gross income for any amount that an individual receives as a qualified catastrophe mitigation payment under a program established by a State or a political subdivision or instrumentality of a State for the purpose of making these payments.

For this purpose, a qualified catastrophe mitigation payment is any amount that an individual receives to make improvements to the individual's residence for the sole purpose of reducing the damage that would be done to the residence by a windstorm, earthquake, or wildfire.

For purposes of the employment tax and self-employment tax provisions of the Code, qualified catastrophe mitigation payments are not treated as net earnings from self-employment, wages, or compensation subject to tax.

Rules similar to the rule denying an increase in the basis of property with respect to which an amount is excluded as a qualified disaster mitigation payment apply in the case of qualified catastrophe mitigation payments.

⁹³ Sec. 139(g)(2).

⁹⁴ *Ibid.*

⁹⁵ Sec. 139(d).

⁹⁶ Sec. 139(g)(3).

⁹⁷ Sec. 139(h).

The proposal extends to qualified catastrophe mitigation payments the present law no-double-benefit rule that applies to qualified disaster relief payments and qualified disaster mitigation payments.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2020.

2. Repeal of temporary limitation on personal casualty losses

Present Law

Personal casualty losses

A taxpayer may generally claim a deduction for any loss sustained during the taxable year, not compensated by insurance or otherwise. For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft.⁹⁸

The term “other casualty” has been defined to mean the complete or partial damage, destruction, or loss of property resulting from an identifiable event of a sudden, unexpected, and unusual nature.⁹⁹ Damage or loss resulting from progressive deterioration of property through a steadily operating cause is not a casualty loss.¹⁰⁰

A casualty loss generally is allowed as a deduction only for the taxable year in which the loss is sustained.¹⁰¹ If the taxpayer has a claim for reimbursement of the loss from insurance or otherwise for which there is a reasonable prospect of recovery, no portion of the loss for which reimbursement may be received is deductible until it can be ascertained with reasonable certainty whether the reimbursement will be received.¹⁰²

The amount of a taxpayer’s casualty loss generally is the decrease in the fair market value of the property as a result of the casualty, limited to the taxpayer’s adjusted basis in the property.¹⁰³ Treasury regulations allow taxpayers to use an alternative method of valuation that

⁹⁸ Sec. 165(c).

⁹⁹ Rev. Rul. 72-592, 1972-2 C.B. 101.

¹⁰⁰ See *Matheson v. Commissioner*, 54 F.2d 537 (2d Cir. 1931).

¹⁰¹ Treas. Reg. sec. 1.165-1(d)(1).

¹⁰² Treas. Reg. sec. 1.165-1(c)(4), (d)(2).

¹⁰³ Treas. Reg. sec. 1.165-7(b).

allows the cost of repairs to the damaged property as evidence of the decrease in value of the property.¹⁰⁴

Personal casualty or theft losses are deductible only if they exceed \$100 per casualty or theft. In addition, aggregate net personal casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income.¹⁰⁵

For losses incurred in taxable years beginning after December 31, 2017, and before January 1, 2026, personal casualty or theft losses are further limited.¹⁰⁶ An individual may claim an itemized deduction for a personal casualty loss (subject to the limitations described above) only if such loss is attributable to a disaster declared by the President to be eligible for Federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. An exception applies to the extent an individual's personal casualty loss does not exceed the individual's personal casualty gains.

Deteriorating concrete foundations

Revenue Procedure 2017-60

On November 23, 2017, prior to enactment of the temporary limitation on personal casualty loss deductions, the IRS published Revenue Procedure 2017-60.¹⁰⁷ The revenue procedure provides a safe harbor that allows an individual to deduct amounts paid to repair damage to his or her personal residence caused by deteriorating concrete foundations containing the mineral pyrrhotite. The revenue procedure describes that residents in the northeastern part of the United States have reported problems with certain residential concrete foundations, which resulted in investigations by the Connecticut Office of the Attorney General and the Connecticut Department of Consumer Protection. Investigators concluded that the presence of pyrrhotite in the concrete used in the foundations was causing the concrete to deteriorate prematurely.

The safe harbor method allows taxpayers to treat certain damage resulting from deteriorating concrete foundations as a casualty loss and provides a formula for determining the amount of the loss. A taxpayer who pays to repair damage to the taxpayer's personal residence caused by a deteriorating concrete foundation may treat the amount paid as a casualty loss in the

¹⁰⁴ Treas. Reg. sec. 1.165-7(a)(2)(ii).

¹⁰⁵ Congress has chosen to modify these requirements in certain recent disaster relief bills. For example, in the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Pub. L. No. 116-260, Div. EE, sec. 304(b), with respect to losses arising from certain qualified disasters in 2020, a taxpayer is allowed a deduction for a personal casualty loss without regard to whether the individual's aggregate net losses exceed 10 percent of AGI, but such a loss is deductible only if it exceeds \$500. See also Pub. L. No. 116-94, sec. 204(b), December 20, 2019 (certain disasters occurring in 2018 and 2019); sec. 20104(b) of Pub. L. No. 115-123 (certain California wildfires); Sec. 504(b) of Pub. L. No. 115-63 (Hurricanes Harvey, Irma, and Maria); and former sec. 1400S(b) (Hurricanes Katrina, Rita, and Wilma).

¹⁰⁶ The temporary limitation on personal casualty or theft loss deductions was enacted in Pub. L. No. 115-97, on December 22, 2017.

¹⁰⁷ 2017-50 I.R.B. 559.

year of payment. To utilize the safe harbor, the taxpayer must obtain a written evaluation from a licensed engineer stating that the foundation was made with defective concrete and may have to satisfy other criteria. The amount of loss that may be claimed under the safe harbor is equal to all unreimbursed amounts paid during the taxable year to repair damage to the taxpayer's personal residence caused by the deteriorating foundation, limited to the taxpayer's adjusted basis in the property. Additional rules apply for taxpayers who have pending claims for reimbursement or intend to pursue reimbursement.

Revenue Procedure 2018-14

On February 18, 2018, following enactment of the temporary limitation on personal casualty loss deductions, the IRS published Revenue Procedure 2018-14, which modified Revenue Procedure 2017-60.¹⁰⁸ Because of the newly-enacted temporary limitation on personal casualty losses for losses incurred in taxable years beginning after December 31, 2017, the IRS stated that a taxpayer generally must have paid to repair damage caused by a deteriorating concrete foundation before January 1, 2018, to claim a casualty loss under the safe harbor in Revenue Procedure 2017-60.

The Treasury Department and IRS modified the safe harbor method in Revenue Procedure 2017-60 to give taxpayers additional time to pay to repair damage to their personal residences. The modified safe harbor allows a taxpayer who pays to repair damage caused by a deteriorating foundation after filing an original 2017 income tax return and before the last day for filing a timely amended return for the 2017 tax year to treat the amount paid as a casualty loss on a timely filed amended return for the 2017 tax year. Accordingly, a taxpayer utilizing the safe harbor method provided by Revenue Procedure 2017-60, as modified by Revenue Procedure 2018-14, for damage caused by a deteriorating concrete foundation generally must have paid to repair the damage prior to May 17, 2021 (or October 15, 2021, if the taxpayer received a filing extension).¹⁰⁹

Description of Proposal

The proposal repeals the temporary limitation on personal casualty or theft losses that limited such losses to those attributable to a Federally declared disaster. The proposal repeals the limitation for losses incurred in taxable years beginning after December 31, 2017. Losses previously limited by the temporary limitation are no longer so limited.

The proposal directs the Secretary to issue regulations or other guidance as necessary to implement the amendments made by the proposal, including regulations or guidance consistent with Revenue Procedure 2017-60. Regulations or guidance consistent with Revenue Procedure 2017-60 would continue to provide a safe harbor to a taxpayer who pays to repair damage to the taxpayer's personal residence caused by a deteriorating concrete foundation, without the time limitation imposed by the modification in Revenue Procedure 2018-14. In addition, the proposal

¹⁰⁸ 2018-9 I.R.B. 378.

¹⁰⁹ See sec. 6511(a); see also Notice 2021-21, 2021-15 I.R.B. 986 (granting an extension to the period of limitations to file a claim for credit or refund of Federal income tax from April 15, 2021, to May 17, 2021).

extends the period of limitations to file a claim for credit or refund by one year in the case of a claim for credit or refund properly allocable to a personal casualty loss described in Revenue Procedure 2017-60, as modified by Revenue Procedure 2018-14, and claimed for taxable years beginning after December 31, 2016. The extension allows a taxpayer utilizing the existing safe harbor method provided by Revenue Procedure 2017-60, as modified by Revenue Procedure 2018-14, an additional year to file an amended return for the 2017 tax year.

Effective Date

The proposal to repeal the temporary limitation of personal casualty and theft losses is effective for losses incurred in taxable years beginning after December 31, 2017.

3. Credit for qualified wildfire mitigation expenditures

Present Law

A deduction is allowed for ordinary and necessary expenses paid or incurred in carrying on a trade or business.¹¹⁰

A taxpayer's basis in real property generally increases as a result of expenditures to improve the property.¹¹¹

Certain enumerated credits for various activities undertaken in connection with a business are allowed in the computation of the general business credit.¹¹²

There is no credit specifically for expenditures with respect to real property for wildfire mitigation.

Description of Proposal

In general

The proposal provides a credit against income tax for 30 percent of the qualified wildfire mitigation expenditures paid or incurred by a taxpayer with respect to real property that the taxpayer owns or leases.

Qualified wildfire mitigation expenditures

Qualified wildfire mitigation expenditures are any specified wildfire mitigation expenditure made under a qualified State wildfire mitigation program of a State that requires expenditures for wildfire mitigation to be paid by the taxpayer and the State. An expense item is

¹¹⁰ Sec. 162.

¹¹¹ Sec. 1016(a).

¹¹² Sec. 38.

not a qualified wildfire mitigation expenditure unless the ratio of the State's expenditure for the item to the sum of the State's and taxpayer's expenditures for the item is at least 25 percent.

A specified wildfire mitigation expenditure is, with respect to real property owned or leased by a taxpayer, any amount paid or incurred to reduce the risk of wildfire by removing accumulations of vegetation (including establishing, expanding, or maintaining fuel breaks to serve as fire breaks) on the real property.

A qualified State wildfire mitigation program is any program of a State the primary purpose of which is to mitigate the risk of wildfires in the State.

An amount that is originally paid or incurred by a taxpayer and is reimbursed by a State under a qualified wildfire mitigation program of that State is treated as paid by the State, not by the taxpayer.

Rules of application

The portion of the credit that is attributable to expenditures made in the ordinary course of the taxpayer's trade or business is treated as a credit that is allowed in the computation of the general business credit. This rule also applies to expenditures made by a State that would have been expenditures made in the ordinary course of a taxpayer's trade or business if they had been made by the taxpayer.

To the extent the credit is not allowed as part of the general business credit, the credit is treated as a nonrefundable personal credit.

Reduction in credit percentage

If a taxpayer's expenditure percentage for any item of qualified wildfire mitigation expenditure is less than 30 percent, the credit percentage for that item equals that expenditure percentage rather than the generally applicable 30-percent credit rate. For this purpose, a taxpayer's expenditure percentage for any item of qualified wildfire mitigation expenditure any portion of which is paid or incurred by a state is the ratio (expressed as a percentage) of the taxpayer's expenditure for the item divided by the sum of the taxpayer's and the State's expenditures for the item.

Special rules

An expenditure is not taken into account in determining the credit if the expenditure is properly allocable to timber that the taxpayer sells or exchanges. This treatment of expenditures related to marketable timber does not apply to the extent that the expenditure exceeds the gain on a sale or exchange of the timber.

If the basis of property otherwise would be determined by taking into account a qualified wildfire mitigation expenditure, the basis of that property is reduced by the amount of the credit allowed with respect to the expenditure (determined without regard to the rule treating the credit as part of the general business credit).

The amount of any deduction or other credit allowable for any expenditure for which the qualified wildfire mitigation expenditure credit is allowable is reduced by the amount of the qualified wildfire mitigation expenditure credit allowed for the expenditure (determined without regard to the rule treating the credit as part of the general business credit).

Effective Date

The proposal applies to expenditures paid or incurred after the date of enactment, in taxable years ending after that date.

F. Low Income Housing Tax Credit

1. Increases in State allocations

Present Law

A taxpayer may claim the low-income housing tax credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. To be eligible for the credit, a low-income building must have received a credit allocation from the State or been financed with the proceeds of certain tax-exempt bonds that are subject to the private activity bond volume limit. For any calendar year, the total amount of housing credits available for allocation by a State is limited to the State housing credit ceiling. However, the amount of housing credit allocated to a low-income building reduces the State housing credit ceiling only once, in the year the housing credit is allocated.

State housing credit ceiling

The State housing credit ceiling is an amount equal to the sum of four components: (1) the unused State housing credit ceiling (if any) for the preceding calendar year (the “unused carryforward component”), (2) the population component, (3) the amount of State housing credit ceiling returned in the calendar year (the “returned credit component”), plus (4) the amount (if any) that the Secretary allocates to the State from the national pool of unused housing credits (the “national pool component”).¹¹³

The unused carryforward component is the excess, if any, of (1) the sum of the population, returned credit, and national pool components for the preceding calendar year, over (2) the aggregate amount of housing tax credits actually allocated by the State for such year, reduced by the amount of credits allocated from such year’s unused State housing credit ceiling.¹¹⁴ Any credits in the unused carryforward component that are not allocated in the current calendar year are forfeited to the national pool.

For calendar year 2021, the population component of the State housing credit ceiling is equal to the greater of (1) \$2.8125 multiplied by the State population or (2) \$3,245,625.¹¹⁵

Description of Proposal

The proposal modifies the population component of the State housing credit ceiling. For 2022, the population component of the State housing credit ceiling is equal to the greater of (1) \$3.22 multiplied by the State population, or (2) \$3,711,575. For 2023, the population component of the State housing credit ceiling is equal to the greater of (1) \$3.70 multiplied by the State

¹¹³ Sec. 42(h)(3)(C); Treas. Reg. sec. 1.42-14(a)(1).

¹¹⁴ Sec. 42(h)(3)(C); Treas. Reg. sec. 1.42-14(b).

¹¹⁵ Rev. Proc. 2020-45. These amounts include a temporary increase enacted in the Consolidated Appropriations Act of 2018, Pub. L. No. 115-141. These limits do not apply in the case of projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit.

population, or (2) \$4,269,471. For 2024, the population component of the State housing credit ceiling is equal to the greater of (1) \$4.25 multiplied by the State population, or (2) \$4,901,620. For 2025, the population component of the State housing credit ceiling is equal to the greater of (1) \$4.88 multiplied by the State population, or (2) \$5,632,880. These amounts are adjusted for inflation in calendar years 2026, 2027, and 2028.

Effective Date

The provision is effective for calendar years beginning after December 31, 2021.

2. Tax-exempt bond financing requirement

Present Law

A taxpayer may claim the low-income housing tax credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

Credit calculations

The applicable percentage for non-Federally subsidized newly constructed housing and non-Federally subsidized substantial rehabilitation is calculated such that the present value of the credit amounts is at least 70 percent of a building's qualified basis, depending on the prevailing interest rate.¹¹⁶ These credits are sometimes referred to as “nine-percent credits.”

The applicable percentage for Federally subsidized newly constructed housing, Federally subsidized substantial rehabilitation, and certain housing acquisition costs, is calculated such that the present value of the credit amounts is at least 30 percent of a building's qualified basis, depending on the prevailing interest rate.¹¹⁷ These credits are sometimes referred to as “four-percent credits.”

¹¹⁶ See sec. 42(b) and (e). This credit is referred to as the 70-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Housing and Economic Recovery Act of 2008, the minimum applicable percentage for such credits was temporarily set at nine percent (the “nine-percent floor”). The Consolidated Appropriations Act, 2016 made the nine-percent floor permanent. The enactment of the nine-percent floor on the credit implies that, under the statutory formula, the present value is always 70 percent or greater.

¹¹⁷ This credit is referred to as the 30-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Consolidated Appropriations Act, 2020, the minimum applicable percentage for such credits was set at four percent (the “four-percent floor”). The enactment of the four-percent floor on the credit implies that, under the statutory formula, the present value is always 30 percent or greater.

Credit allocations

A low-income housing tax credit is generally allowable only if the building owner receives a housing credit allocation from a State or local housing credit agency. The amount of housing credit allocated by a State to a low-income building reduces the State housing credit ceiling only once, in the year the housing credit is allocated.

Special rule for buildings financed by tax-exempt bonds

If 50 percent or more of the aggregate basis of the building and the land on which the building is located is financed by the proceeds of tax-exempt bonds, a low-income housing tax credit is allowable with respect to the entire eligible basis of the project without an allocation from the State or local housing credit agency and at no charge to the States' housing tax credit cap. If less than 50 percent of the aggregate basis is so financed, a low-income housing tax credit is allowable only with respect to the portion financed by the proceeds of tax-exempt bonds. The tax-exempt bonds must be subject to the volume cap for private activity bonds and once bond proceeds are used to finance a project, principal payments on such financing must be applied within a reasonable period to redeem the bonds.¹¹⁸

Description of Proposal

The proposal modifies the rule which allows a low-income housing tax credit on the entire eligible basis of a building without an allocation from the State or local housing credit agency and at no charge to the States' housing tax credit cap as long as more than 50 percent of the aggregate basis is financed with certain tax-exempt bonds. The percent limitation is lowered from 50 percent to 25 percent for buildings which are financed by the proceeds of certain tax-exempt bonds issued in calendar year 2022, 2023, 2024, 2025, 2026, 2027, or 2028 (and not by any obligation taken into account during any taxable year beginning during calendar year 2019, 2020, or 2021).

Effective Date

The proposal applies to buildings placed in service in taxable years beginning after December 31, 2021.

3. Buildings designated to serve extremely low-income households

Present Law

A taxpayer may claim the low-income housing tax credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants.

To be eligible for the credit, a low-income building must have received a credit allocation from the State or been financed with the proceeds of certain tax-exempt bonds that are subject to

¹¹⁸ Sec. 42(h)(4)(A).

the private activity bond volume limit. For any calendar year, the total amount of housing credits available for allocation by a State is limited to the State housing credit ceiling.

Under present law, at least 10 percent of the State housing credit ceiling of a State must be set aside and allocated to qualified low-income housing projects.¹¹⁹ For this purpose, the term “qualified low-income housing project” means a project in which a qualified nonprofit organization owns an interest (directly or through a partnership) and materially participates in the development and operation of the project throughout the project’s compliance period.

Generally, buildings located in high cost areas are eligible for enhanced low-income housing tax credit, which is effectuated by increasing such buildings’ eligible basis or the rehabilitation expenditures taken into account for purposes of the credit. For this purpose, qualified census tracts and difficult development areas are treated as high cost areas.¹²⁰ Buildings designated by a State housing credit agency as requiring enhanced credit in order to be financially feasible are also treated as located in difficult development areas. For a building located in a high cost area, the eligible basis of such building is increased to 130 percent of the otherwise applicable eligible basis, or, in the case of a substantial rehabilitation, the rehabilitation expenditures taken into account are increased to 130 percent of the otherwise applicable rehabilitation expenditures.

Description of Proposal

The proposal adds a new set-aside requirement for certain buildings with extremely low-income households. The proposal requires that at least 10 percent of the State housing credit ceiling of a State be allocated to certain buildings with extremely low-income households. Such buildings are buildings where 20 percent or more of the residential units are rent-restricted (determined as if the imputed income limitation applicable to such units were 30 percent of area median gross income), which have been designated by the taxpayer for occupancy by households the aggregate household income of which does not exceed the greater of (1) 30 percent of area median gross income, or (2) 100 percent of an amount equal to the Federal poverty (“extremely low-income buildings”). The requirements of the new set-aside do not apply to allocations after December 31, 2031.

The proposal also makes certain extremely low-income buildings eligible for enhanced low-income housing tax credit. For any extremely low-income building which is designated by the State housing credit agency as requiring an increase in credit in order for the building to be financially feasible, such building’s eligible basis is increased to 150 percent of the otherwise applicable eligible basis. However, a housing credit agency may not allocate more than 15 percent of the portion of the State housing credit ceiling amount to such buildings. In addition, in the case of projects financed by tax-exempt bonds, a State may not issue more than 10 percent of its private activity bond volume cap to such buildings. The enhanced credit is not available for allocations made after December 31, 2031.

¹¹⁹ Sec. 42(h)(5).

¹²⁰ See sec. 42(d)(5)(B).

Effective Date

The proposal is effective for allocations, and determinations, of housing credit dollar amount after December 31, 2021.

4. Inclusion of rural areas as difficult development areas

Present Law

A taxpayer may claim the low-income housing tax credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.¹²¹

Credit calculations

Determination of applicable percentage

The applicable percentage for non-Federally subsidized newly constructed housing and non-Federally subsidized substantial rehabilitation is calculated such that the present value of the credit amounts is at least 70 percent of a building's qualified basis, depending on the prevailing interest rate.¹²² These credits are sometimes referred to as "nine-percent credits."

The applicable percentage for Federally subsidized newly constructed housing, Federally subsidized substantial rehabilitation, and certain housing acquisition costs, is calculated such that the present value of the credit amounts is at least 30 percent of a building's qualified basis, depending on the prevailing interest rate.¹²³ These credits are sometimes referred to as "four-percent credits."

¹²¹ Sec. 42.

¹²² See sec. 42(b) and (e). This credit is referred to as the 70-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Housing and Economic Recovery Act of 2008, the minimum applicable percentage for such credits was temporarily set at nine percent (the "nine-percent floor"). The Consolidated Appropriations Act, 2016 made the nine-percent floor permanent. The enactment of the nine-percent floor on the credit implies that, under the statutory formula, the present value is always 70 percent or greater.

¹²³ This credit is referred to as the 30-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Consolidated Appropriations Act, 2020, the minimum applicable percentage for such credits was set at four percent (the "four-percent floor"). The enactment of the four-percent floor on the credit implies that, under the statutory formula, the present value is always 30 percent or greater.

Calculation of eligible basis

The qualified basis for purposes of determining the amount of low-income housing credit to be claimed each year is an amount equal to the applicable fraction of eligible basis.¹²⁴ The eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period. The eligible basis of an existing building is zero unless the building meets the following requirements: the building is acquired by purchase; there is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service; the building was not previously placed in service by the taxpayer or a related person; and the building was rehabilitated and is eligible for the low income housing credit for rehabilitation expenditures treated as a separate new building.

Generally, buildings located in high cost areas are eligible for enhanced low-income housing tax credit, which is effectuated by increasing such buildings' eligible basis or the rehabilitation expenditures taken into account for purposes of the credit. For this purpose, qualified census tracts and difficult development areas are treated as high cost areas.¹²⁵ A qualified census tract is a census tract designated by the Secretary of Housing and Urban Development in which 50 percent or more of households have an income of less than 60 percent of area median gross income, or which has a poverty rate of at least 25 percent. A difficult development area is an area designated by the Secretary of Housing and Urban Development in which construction, land, or utility costs are high relative to area median gross income.

In the case of a new building located in a qualified census tract or difficult development area, the eligible basis is increased to 130 percent of such basis calculated without regard to this increase. In the case of a substantial rehabilitation to an existing building, the rehabilitation expenditures taken into account are increased to 130 percent of such expenditures calculated without regard to this increase.

Qualified allocation plans

A low-income housing tax credit is allowable only if the building owner receives a housing credit allocation from a State or local housing credit agency. Generally, the aggregate credit authority provided annually to each State for calendar year 2021 is \$2.8125 multiplied by the State population, with a minimum annual cap of \$3,245,625 for certain small population States and territories.¹²⁶ In turn, each State and local housing credit agency allocates credits to

¹²⁴ Sec. 42(c)(1)(A).

¹²⁵ Sec. 42(d)(5)(B).

¹²⁶ See Notice 2021-19, 2021-11 I.R.B. 920, March 15, 2021. Section 42(h)(3)(I) provides for an increase in the State housing credit ceiling for 2018, 2019, 2020, and 2021. The increase is calculated by multiplying the State housing credit ceiling by 1.125.

In 2021, the most recent year for which the IRS has issued population estimates for purposes of the low-income housing tax credit, the small population States are Alaska, Delaware, the District of Columbia, Montana, North Dakota, Rhode Island, South Dakota, Vermont, and Wyoming. The small population territories are American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands. *Ibid.*

developers of low income rental housing pursuant to a qualified allocation plan which sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions; which gives preference to serving the lowest income tenants, projects obligated to serve qualified tenants for the longest periods, and projects which are located in qualified census tracts that contribute to community revitalization; and which provides a procedure for the housing credit agency to follow in monitoring for noncompliance.

Description of Proposal

The proposal amends the definition of difficult development area to include any rural area for the purpose of determining eligible basis. A rural area is defined to be any non-metropolitan area, or any open country, place, town, village, or city which is not part of or associated with an urban area and either has low population or is not contained within a standard metropolitan statistical area and has a serious lack of mortgage credit for lower and moderate-income families, as determined by the Secretary of Agriculture and the Secretary of Housing and Urban Development¹²⁷ and which is identified by the qualified allocation plan of the housing credit agency.

Effective Date

The proposal applies to buildings placed in service after December 31, 2021.

5. Repeal of qualified contract option

Present Law

A taxpayer may claim the low-income housing tax credit annually over a 10-year credit period for the costs of building or rehabilitating rental housing occupied by low-income tenants.¹²⁸ The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.¹²⁹

State housing credit ceiling

A low-income housing tax credit is generally allowable only if the building owner receives a housing credit allocation from a State or local housing credit agency.¹³⁰ The aggregate credit authority provided annually to each State for calendar year 2021 is \$2.8125 multiplied by the State population, with a minimum annual cap of \$3,245,625 for certain small

¹²⁷ 42 U.S.C. 1490

¹²⁸ Sec. 42.

¹²⁹ Sec. 42(a).

¹³⁰ Sec. 42(h)(1).

population States.¹³¹ The amount of housing credit allocated by a State to a low-income building reduces the State housing credit ceiling only once, in the year the housing credit is allocated. However, credit allocations are not needed for buildings that receive 50 percent or more of their financing from the proceeds of tax-exempt bonds that are subject to the private activity bond volume limit.¹³² These projects must still satisfy the qualified allocation plan (“QAP”) requirements and financial feasibility determinations that apply to projects receiving allocations.¹³³

Qualified low-income housing projects and qualified low-income buildings

A qualified low-income building is a building that is subject to a 15-year compliance period and is part of a qualified low-income housing project.¹³⁴ The 10-year credit period and 15-year compliance period generally start in the first taxable year in which the building is placed into service.¹³⁵

Minimum set-aside requirement

To meet the minimum set-aside requirement, a qualified low-income housing project must satisfy one of three tests (whichever is elected by the taxpayer):¹³⁶

- **20-50 test.** The 20-50 test is met if 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income.
- **40-60 test.** The 40-60 test is met if 40 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

¹³¹ See Notice 2021-19, 2021-11 I.R.B. 920, March 15, 2021. Section 42(h)(3)(I) provides for an increase in the State housing credit ceiling for 2018, 2019, 2020, and 2021. The increase is calculated by multiplying the State housing credit ceiling by 1.125.

In 2021, the most recent year for which the IRS has issued population estimates for purposes of the low-income housing tax credit, the small population States were Alaska, Delaware, the District of Columbia, Montana, North Dakota, Rhode Island, South Dakota, Vermont, and Wyoming. *Ibid.*

¹³² Sec 42(h)(4)(B). If less than 50 percent of a building is financed with tax-exempt bonds, only the portion of credits attributable to the bond-financed portion of the building is allowed without a location. Sec. 42(h)(4)(A).

¹³³ Sec. 42(m)(1)(D), (m)(2)(D).

¹³⁴ Sec. 42(c)(2).

¹³⁵ Sec. 42(f), (i)(1).

¹³⁶ Sec. 42(g)(1). The 40-60 test is used to satisfy the minimum set-aside requirement in the majority of projects. For example, in 2019, the 40-60 test was used for 100 percent of units in 16 States. In only three States was the 40-60 test used for less than 50 percent of the units in the State (45 percent in Indiana, 35 percent in Nevada, and 45 percent in Virginia). NCSHA, HFA Factbook: 2019 Annual Survey Results, Table 9.

- Average income test. The average income test is met if 40 percent or more (25 percent or more in the case of a project located in a high cost housing area) of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer with respect to the respective unit. The imputed income limitation is determined in 10-percentage-point increments, and may be designated as 20, 30, 40, 50, 60, 70, or 80 percent. The average of the imputed income limitations designated must not exceed 60 percent of area median gross income.¹³⁷

Extended use period

To be eligible for housing credits, a building owner is generally required to enter into an extended low-income housing commitment with the housing credit agency to maintain housing affordability restrictions on the property for an additional 15 years following the end of the initial 15-year compliance period (the “extended use period”).¹³⁸ However, the extended use period may be terminated early under three scenarios: (1) if the building is acquired by foreclosure,¹³⁹ (2) if the building owner exercises the qualified contract option,¹⁴⁰ or (3) where a qualified nonprofit organization or other qualified buyer has a right of first refusal, if such buyer exercises the right.¹⁴¹

Qualified contracts

To exercise the qualified contract option, the building owner must submit to the housing credit agency a written request to find a buyer that agrees to acquire the owner’s interest in the low-income portion of the building.¹⁴² An owner may only make such a request after the 14th year of the compliance period.¹⁴³

The housing credit agency has a period of one year beginning on the date the owner makes the written request to produce a qualified contract, in which a buyer agrees to acquire the building at a specified statutory price.¹⁴⁴

¹³⁷ In October 2020, the IRS published proposed regulations setting forth guidance on administering the average income test. 85 Fed. Reg. 68816, October 30, 2020.

¹³⁸ Sec. 42(h)(6).

¹³⁹ Sec. 42(h)(6)(E)(i)(I).

¹⁴⁰ Sec. 42(h)(6)(E)(i)(II), (F); see also Treas. Reg. sec. 1.42-18(a).

¹⁴¹ See sec. 42(i)(7).

¹⁴² Sec. 42(h)(6)(I).

¹⁴³ *Ibid.*

¹⁴⁴ Sec. 42(h)(6)(E)(i)(II).

For any non low-income portion of the building the price is the fair market value.¹⁴⁵ For the low-income portion of the building the price is an amount not less than the applicable fraction of the sum of (1) the outstanding indebtedness secured by, or with respect to, the building; (2) the adjusted investor equity in the building; plus (3) other capital contributions; but reduced by (4) cash distributions from the project.¹⁴⁶

If the agency is unable to present a qualified contract before the end of the one-year period, the building's extended use period terminates and the housing affordability restrictions are removed.¹⁴⁷

The qualified contract exception does not apply to the extent more stringent termination requirements are provided in the agreement with the housing credit agency or in State law.¹⁴⁸

Description of Proposal

The proposal eliminates the qualified contract exception for buildings receiving allocations after January 1, 2022. Specifically, the proposal limits the use of the exception to (1) buildings that received housing credit allocations before January 1, 2022, or (2) with respect to buildings financed with tax-exempt bonds, buildings that received before January 1, 2022 a determination from the issuer of the tax-exempt bonds or the housing credit agency that the building has satisfied the QAP requirements and the financial feasibility determination.

In addition, for buildings that may still make use of the qualified contract exception, the proposal modifies the specified statutory price. The price for any non-low income portion remains the fair market value. The price for the low-income portion is the fair market value, determined by the housing credit agency taking into account the rent restrictions required to continue to satisfy the minimum set aside requirements. The Secretary is directed to prescribe regulations necessary or appropriate to the determination of the specified statutory price.

Effective Date

The proposal is generally effective date of enactment.

The proposal to modify the specified statutory price applies to buildings with respect to which the building owner submits, after the date of enactment, a written request to find a buyer that agrees to acquire the owner's interest in the low-income portion of the building.

¹⁴⁵ Sec. 42(h)(6)(F).

¹⁴⁶ *Ibid.*

¹⁴⁷ Sec. 42(h)(6)(E)(i)(II).

¹⁴⁸ Sec. 42(h)(6)(E)(i).

6. Modification and clarification of rights relating to building purchase

Present Law

A taxpayer may claim the low-income housing tax credit annually over a 10-year credit period for the costs of building or rehabilitating rental housing occupied by low-income tenants.¹⁴⁹ The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.¹⁵⁰

State housing credit ceiling and QAPs

A low-income housing tax credit is generally allowable only if the building owner receives a housing credit allocation from a State or local housing credit agency.¹⁵¹ The aggregate credit authority provided annually to each State for calendar year 2021 is \$2.8125 multiplied by the State population, with a minimum annual cap of \$3,245,625 for certain small population States.¹⁵² The amount of housing credit allocated by a State to a low-income building reduces the State housing credit ceiling only once, in the year the housing credit is allocated. However, credit allocations are not needed for buildings that receive 50 percent or more of their financing from the proceeds of tax-exempt bonds that are subject to the private activity bond volume limit.¹⁵³ These projects must still satisfy the qualified allocation plan (“QAP”) requirements and financial feasibility determinations that apply to projects receiving allocations.¹⁵⁴

The low-income housing credit must be allocated pursuant to a housing credit agency’s QAP.¹⁵⁵ A QAP is defined as any plan that (1) sets forth the selection criteria to be used to determine the housing priorities of the housing credit agency which are appropriate to local conditions, (2) which give preference in allocating housing credit to certain projects (*e.g.*, projects serving the lowest income tenants), and (3) which provide a procedure that the agency

¹⁴⁹ Sec. 42.

¹⁵⁰ Sec. 42(a).

¹⁵¹ Sec. 42(h)(1).

¹⁵² See Notice 2021-19, 2021-11 I.R.B. 920, March 15, 2021. Section 42(h)(3)(I) provides for an increase in the State housing credit ceiling for 2018, 2019, 2020, and 2021. The increase is calculated by multiplying the State housing credit ceiling by 1.125.

In 2021, the most recent year for which the IRS has issued population estimates for purposes of the low-income housing tax credit, the small population States were Alaska, Delaware, the District of Columbia, Montana, North Dakota, Rhode Island, South Dakota, Vermont, and Wyoming. *Ibid.*

¹⁵³ Sec 42(h)(4)(B). If less than 50 percent of a building is financed with tax-exempt bonds, only the portion of credits attributable to the bond-financed portion of the building is allowed without a location. Sec. 42(h)(4)(A).

¹⁵⁴ Sec. 42(m)(1)(D), (m)(2)(D).

¹⁵⁵ Sec. 42(m).

will follow in monitoring for noncompliance and in notifying the IRS of such noncompliance and in monitoring for noncompliance with habitability standards through regular site visits.¹⁵⁶ QAPs must use the following selection criteria: project location, housing needs characteristics, project characteristics, sponsor characteristics, tenant populations with special housing needs, public housing waiting lists, tenant populations of individuals with children, projects intended for eventual tenant ownership, the energy efficiency of the project, and the historic nature of the project.¹⁵⁷

Qualified low-income housing projects and qualified low-income buildings

A qualified low-income building is a building that is subject to a 15-year compliance period and is part of a qualified low-income housing project.¹⁵⁸ The 10-year credit period and 15-year compliance period generally start in the first taxable year in which the building is placed into service.¹⁵⁹

Extended Use Period

To be eligible for housing credits, a building owner is generally required to enter into an extended low-income housing commitment with the housing credit agency to maintain housing affordability restrictions on the property for an additional 15 years following the end of the initial 15-year compliance period (the “extended use period”).¹⁶⁰ However, the extended use period may be terminated early under three scenarios: (1) if the building is acquired by foreclosure,¹⁶¹ (2) if the building owner exercises the qualified contract option,¹⁶² or (3) where a qualified nonprofit organization or other qualified buyer has a right of first refusal, if such buyer exercises the right.¹⁶³

Right of First Refusal

¹⁵⁶ Sec. 42(m)(1)(B).

¹⁵⁷ Sec. 42(m)(1)(C).

¹⁵⁸ Sec. 42(c)(2).

¹⁵⁹ Sec. 42(f), (i)(1).

¹⁶⁰ Sec. 42(h)(6).

¹⁶¹ Sec. 42(h)(6)(E)(i)(I).

¹⁶² Sec. 42(h)(6)(E)(i)(II), (F); *see also* Treas. Reg. sec. 1.42-18(a).

¹⁶³ *See* sec. 42(i)(7).

Ownership structures

The low-income housing tax credit may be claimed against income tax liability, but it is not refundable.¹⁶⁴ Investors in credit projects may also be entitled to other benefits such as depreciation¹⁶⁵ or interest deductions.¹⁶⁶ Certain entities, such as nonprofit organizations that foster low-income housing or tenant cooperatives or resident management corporations, may have an interest in developing or continuing qualified low-income housing projects. However, to the extent that these entities have no Federal income tax liability, they are unable to claim the credit or related deductions.¹⁶⁷

In order to use these benefits, the nonprofit organization or other entity may develop low-income housing projects in an ownership structure with taxable investors. For example, a nonprofit organization may join with taxable investors to form a partnership. Under such a structure, the partnership owns the qualified low-income building and generally allocates the low-income housing tax credit and deductions to taxable investors.¹⁶⁸

Right of first refusal safe harbor

At the time of acquisition of a building, credit investors may want to grant an option or other right to a nonprofit organization or other entity, in a contract or other agreement, the right to acquire the building at the end of the compliance period. For example, credit investors in a partnership may want to grant a right to acquire the building at the end of the compliance period to the nonprofit organization developer partner.

A taxpayer's grant of an option or other right to acquire property to another party may, depending on the terms, cause the taxpayer to not be treated as the owner of the property for Federal income tax purposes.¹⁶⁹ If the taxpayer is not treated as the tax owner of the property, the taxpayer generally is not able to claim credits or deductions with respect to the property.

The low-income housing tax credit rules provide a safe harbor where the grant by a taxpayer of certain rights to acquire a qualified low-income building will not cause a loss in Federal income tax benefits. Under the safe harbor, no Federal income tax benefit fails to be allowable to a taxpayer with respect to any qualified low-income building merely by reason of a right of first refusal that is (1) held by a qualified nonprofit organization or certain other qualified

¹⁶⁴ See sec. 38. Additionally, the credit generally may offset alternative minimum tax. Sec. 38(c).

¹⁶⁵ See sec. 167. The credit does not reduce the taxpayer's basis in the qualified low-income building. *Cf.* sec. 50(c) (providing that, if a credit is determined under the investment credit with respect to any property, the basis of such property shall be reduced by the amount of the credit so determined).

¹⁶⁶ See sec. 163.

¹⁶⁷ Sec. 501.

¹⁶⁸ See sec. 704(b); Treas. Reg. sec. 1.704-1(b)(4)(ii).

¹⁶⁹ See, e.g., *Frank Lyon Co. v. Commissioner*, 435 U.S. 561 (1978), *Dettmers v. Commissioner*, 430 F.2d 1019 (6th Cir. 1970).

buyers (2) to purchase the building (3) after the end of the compliance period (4) for a price not less than the minimum purchase price.¹⁷⁰

A qualified nonprofit organization is (1) a nonprofit organization¹⁷¹ (2) determined by the State housing credit agency not to be affiliated with a or controlled by a for-profit organization, (3) that has as an exempt purpose the fostering of low-income housing.¹⁷²

The minimum purchase price is an amount equal to the sum of the principal amount of indebtedness secured by the building (other than indebtedness incurred within the five-year period ending on the date of the sale), plus certain exit taxes.¹⁷³

The safe harbor is silent as to whether the right to purchase all of the interests in a partnership that owns a qualified low-income building satisfies the safe harbor,¹⁷⁴ or whether the right to purchase assets relating to the building satisfies the safe harbor.

The safe harbor does not require credit building owners to grant a right of first refusal. However, in some states, housing credit agencies favor low-income housing credit applications that give qualified nonprofit organizations or certain other parties a right of first refusal.

Right of first refusal safe harbor and State law

A right of first refusal is a contractual right defined under State law. In general, a right of first refusal is “a potential buyer’s contractual right to meet the terms of a third party’s highest offer.”¹⁷⁵

A right of first refusal is a subset of a purchase option, which is a “contractual provision by which an owner of realty enters an agreement with another allowing the latter to buy the property at a specified price within a specified time, or within a reasonable time in the future, but without imposing an obligation to purchase on the person to whom it is given.”¹⁷⁶ In general, an option does not require a third-party offer, while a right of first refusal does.

A number of State courts have come to different conclusions as to what criteria must be satisfied in order to trigger a right of first refusal grant that meets the low-income housing tax credit safe harbor. For example, in *Homeowner’s Rehab*, the court held that neither a bona fide

¹⁷⁰ Sec. 42(i)(7)(A).

¹⁷¹ The organization must be exempt from tax under sections 501(c)(3) or (4).

¹⁷² Sec. 42(h)(5).

¹⁷³ Sec. 42(i)(7)(B).

¹⁷⁴ But see Rev. Rul. 99-6, 1999-6 I.R.B. 6.

¹⁷⁵ Black’s Law Dictionary (11th ed. 2019), right of first refusal.

¹⁷⁶ Black’s Law Dictionary (11th ed. 2019), definition 5, option to purchase real property.

third-party offer nor the approval of the offer by the building owner is needed.¹⁷⁷ In contrast, in *Senior Housing Assistance Group*, the court held that a bona fide third-party offer acceptable to the property owner is needed.¹⁷⁸

Description of Proposal

The proposal changes the right of first refusal safe harbor into an option safe harbor.

For existing agreements, the proposal clarifies, for purposes of the safe harbor, that the right to acquire the building includes the right to acquire all of the partnership interests relating to the building.¹⁷⁹ It also clarifies that the right to acquire the building includes the right to acquire assets held for the development, operation, or maintenance of the building. Thus, agreements which provide for the right to acquire these partnership interests or building assets do not fail to satisfy the safe harbor.

For existing agreements, the proposal also clarifies that the right of first refusal safe harbor may be satisfied by the grant of an option. A right of first refusal may be exercised in response to an offer by a related party; a bona fide third-party offer is not needed. A right of first refusal may be exercised without the approval of any owner of a credit project. Thus, agreements with these terms do not fail to satisfy the safe harbor.

Finally, the proposal amends the minimum purchase price to exclude exit taxes. Thus, agreements that do not include exit taxes as part of the minimum purchase price do not fail to satisfy the safe harbor.

Effective Date

The proposal to change the right of first refusal safe harbor into an option safe harbor is effective for agreements entered into or amended after the date of enactment.

The other provisions of the proposal are effective for agreements entered into before, on, or after the date of enactment. However, none of the changes of the proposal are intended to supersede express language in any agreement with respect to the terms of a right of first refusal or option permitted under the safe harbor.

7. Increase in credit for bond-financed projects designated by housing credit agency

Present Law

¹⁷⁷ *Homeowner's Rehab, Inc v. Related Corp. VSLP, L.P.*, 479 Mass. 741 (2018).

¹⁷⁸ *Senior Housing Assistance Grp. v. AMTAX Holdings 260, LLC*, No. C17-1115RSM, 2019 WL 1417299 (W.D. Wash. Mar. 29, 2019), *appeal dismissed*, No. 19-35354, 2019 WL 5576461 (9th Cir. Sept. 13, 2019).

¹⁷⁹ This excludes partnership interests of the right holder or a related person within the meaning of section 267(b) or 707(b)(1).

A taxpayer may claim the low-income housing tax credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.¹⁸⁰

Credit calculations

Determination of applicable percentage

The applicable percentage for non-Federally subsidized newly constructed housing and non-Federally subsidized substantial rehabilitation is calculated such that the present value of the credit amounts is at least 70 percent of a building's qualified basis, depending on the prevailing interest rate.¹⁸¹ These credits are sometimes referred to as "nine-percent credits."

The applicable percentage for Federally subsidized newly constructed housing, Federally subsidized substantial rehabilitation, and certain housing acquisition costs, is calculated such that the present value of the credit amounts is at least 30 percent of a building's qualified basis, depending on the prevailing interest rate.¹⁸² These credits are sometimes referred to as "four-percent credits."

Calculation of eligible basis

The qualified basis for purposes of determining the amount of low-income housing credit to be claimed each year is an amount equal to the applicable fraction of eligible basis.¹⁸³ The eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period. The eligible basis of an existing building is zero unless the building meets the following requirements: the building is acquired by purchase; there is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service; the building was not previously placed in service by the taxpayer or a related person;

¹⁸⁰ Sec. 42.

¹⁸¹ See sec. 42(b) and (e). This credit is referred to as the 70-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Housing and Economic Recovery Act of 2008, the minimum applicable percentage for such credits was temporarily set at nine percent (the "nine-percent floor"). The Consolidated Appropriations Act, 2016 made the nine-percent floor permanent. The enactment of the nine-percent floor on the credit implies that, under the statutory formula, the present value is always 70 percent or greater.

¹⁸² This credit is referred to as the 30-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Consolidated Appropriations Act, 2020, the minimum applicable percentage for such credits was set at four percent (the "four-percent floor"). The enactment of the four-percent floor on the credit implies that, under the statutory formula, the present value is always 30 percent or greater.

¹⁸³ Sec. 42(c)(1)(A).

and the building was rehabilitated and is eligible for the low income housing credit for rehabilitation expenditures treated as a separate new building.

Special statutory rules for determining eligible basis include increased credit amounts for buildings located in qualified census tracts or difficult development areas.¹⁸⁴ A qualified census tract is a census tract designated by the Secretary of Housing and Urban Development in which 50 percent or more of households have an income of less than 60 percent of area median gross income, or which has a poverty rate of at least 25 percent. A difficult development area is an area designated by the Secretary of Housing and Urban Development in which construction, land, or utility costs are high relative to area median gross income.

In the case of a new building, the eligible basis in qualified census tracts or difficult development areas is increased to 130 percent of such basis calculated without regard to this increase. For an existing building, the rehabilitation expenditures are increased to 130 percent of such expenditures calculated without regard to this increase.

State housing credit agencies may designate a building as requiring an increase in credit in order for such building to be financially feasible as part of a qualified low-income housing project. A building so designated is treated as though it were located in a difficult development area for purposes of determining eligible basis. However, a designated building is not treated as located in a difficult development area if the building is financed with the proceeds of tax-exempt bonds which are subject to the volume cap for private activity bonds and for which principal payments on such financing are applied within a reasonable period to redeem the bonds after bond proceeds are used to finance a project.¹⁸⁵

Description of Proposal

The proposal modifies the rule which treats as difficult development areas for purposes of determining eligible basis, those buildings designated by housing credit agencies as requiring an increase in credit. Under the proposal, buildings so designated and financed with the proceeds of certain tax-exempt bonds are treated as difficult development areas for purposes of determining eligible basis as long as the determinations of housing credit dollar amounts are not made after December 31, 2028.

Effective Date

The proposal applies to buildings which receive a determination of housing credit dollar amount pursuant to section 42(m)(2)(D) of the Code after the date of enactment.

¹⁸⁴ Sec. 42(d)(5)(B).

¹⁸⁵ Sec. 42(h)(4)(A).

G. Neighborhood Homes Credit

Present Law

Several provisions of the Code provide favorable tax treatment to homeowners. These include: (1) the home mortgage interest deduction; (2) the capped deduction for real property taxes; (3) the exclusion of gain from sale of a principal residence; (4) tax-exempt bonds for owner-occupied housing; (5) mortgage credit certificates; (6) qualified first-time homebuyer distributions from an individual retirement plan; (7) exclusion from gross income of the rental value of parsonages and military housing allowances; and (8) exclusion from gross income of discharge of certain qualified principal residence indebtedness.

Certain tax benefits are also available for rental housing. These include: (1) the low-income housing tax credit, (2) the rehabilitation credit, (3) the exclusion of interest on State and local government qualified private activity bonds, (4) expensing of qualified improvement property and tangible personal property under bonus depreciation, (5) exceptions from the passive activity loss rules for certain rental real estate activities, (6) the rental real estate safe harbor for the section 199A deduction, and (7) the election out of the interest limitation for real property trades or businesses.¹⁸⁶

The Code does not presently provide a general business credit to subsidize the new construction or substantial rehabilitation of owner-occupied affordable housing.

Description of Proposal

The proposal adds a new neighborhood homes credit as part of the general business credit.¹⁸⁷ The credit may be provided to (1) taxpayers that develop or rehabilitate property that will be sold to an eligible purchaser who will use the property as the purchaser's principal residence, or (2) taxpayers that rehabilitate certain owner-occupied property.

Credit calculation and definitions

Generally, the credit amount for a taxable year with respect to a qualified residence sold by a taxpayer in an affordable sale is the lesser of (1) the excess (if any) of (i) the reasonable development costs paid or incurred by the taxpayer with respect to the qualified residence, over (ii) the sale price of the qualified residence (reduced by any reasonable expenses paid or incurred by the taxpayer in connection with such sale); or (2) 35 percent of the lesser of (i) the eligible development costs paid or incurred by the taxpayer with respect to the qualified residence, or (ii) 80 percent of the national median sale price for new homes (as determined pursuant to the most recent census data available as of the credit allocation date). As discussed below, an alternative method for calculating credit amounts is used in the case of certain rehabilitations of owner-occupied residences.

¹⁸⁶ Sec. 163(j)(7).

¹⁸⁷ See sec. 38.

For purposes of the credit, the term “reasonable development costs” means amounts paid or incurred for the acquisition of buildings and land, construction, substantial rehabilitation, demolition of structures, or environmental remediation, to the extent that such amounts are determined by the neighborhood homes credit agency (as of the date on which the construction or substantial rehabilitation is substantially complete) as meeting the standards promulgated by the agency.¹⁸⁸ The term “neighborhood homes credit agency” means the agency designated by the governor of a State¹⁸⁹ as the State’s neighborhood homes credit agency. The term “eligible development costs” means the amount which would be reasonable development costs if the amounts taken into account as paid or incurred for the acquisition of buildings and land did not exceed 75 percent of the costs determined without regard to any amount paid or incurred for the acquisition of buildings and land.¹⁹⁰

Reasonable development costs and eligible development costs do not include any amounts paid or incurred before the date on which an allocation is made to a taxpayer with respect to the qualified project of which the qualified residence is part, unless the amount paid or incurred is for the acquisition of buildings or land. Amounts paid or incurred for the acquisition of buildings or land are included only if paid or incurred not more than three years before the allocation date. If a taxpayer acquires any building or land from an entity (or any related party to the entity) that holds an ownership interest in the taxpayer, the entity must also have acquired the property within the three-year period, and taxpayer’s acquisition costs may not exceed the amount paid or incurred by the entity to acquire the property.

The term “substantial rehabilitation” means amounts paid or incurred for the rehabilitation of a qualified residence if such amounts exceed the greater of (1) \$20,000, or (2) 20 percent of the amounts paid or incurred for the acquisition of buildings and land.

In the case of qualified residences that are condominium units or houses or apartments owned by a cooperative housing corporation,¹⁹¹ the reasonable development costs and eligible development costs of the qualified residence are equal to the costs of the entire condominium or

¹⁸⁸ In making its determination, the agency must consider: (1) the sources and uses of funds and total financing, (2) any proceeds or receipts expected to be generated by reason of tax benefits, and (3) the reasonableness of the development costs and fees.

¹⁸⁹ For purposes of this proposal, the term “State” includes the District of Columbia and the possessions of the United States.

¹⁹⁰ Under this definition, eligible development costs will be lower than reasonable development costs for a qualified residence when the acquisition costs of buildings and land are significantly higher than the other reasonable development costs for such residence. For example, assume a qualified residence had reasonable development costs of \$1800, with \$800 of acquisition costs for building and land and \$1000 of other reasonable development costs. In that case, the \$800 of acquisition costs exceeds 75 percent of the other costs (75 percent of \$1000 = \$750). Therefore, the eligible development costs are equal to the sum of 75 percent of the other costs (\$750) and the other costs (\$1000), or \$1750.

¹⁹¹ With respect to cooperative housing corporations (as such term is defined in section 216(b)), tenant-stockholders are treated as owning the house or a partment which they are entitled to occupy.

cooperative housing property, multiplied by the qualified residence's share of the total floor space (relative to the total floor space of all residences within the property).

“Qualified residence” means a residence that (1) is real property affixed on a permanent foundation, (2) is (i) a house which contains four or fewer residential units, (ii) a condominium unit, or (iii) a house or apartment owned by a cooperative housing; (3) is part of a qualified project which has received an allocation from a neighborhood homes credit agency, and (4) is located in a qualified census tract (determined as of the date of such allocation).

To be a qualified census tract, a census tract must satisfy one of the following sets of conditions:

1. The census tract must (i) have a median family income¹⁹² which does not exceed 80 percent of the median family income for the applicable area, (ii) has a poverty rate that is not less than 130 percent of the poverty rate of the applicable area, and (iii) has a median value for owner-occupied homes that does not exceed the median value for owner-occupied homes in the applicable area;
2. The census tract must (i) be located in a city with a population of at least 50,000 and a poverty rate that is at least 150 percent of the poverty rate of the applicable area, (ii) has a median family income which does not exceed the median family income for the applicable area, and (iii) has a median value for owner-occupied homes that does not exceed 80 percent of the median value for owner-occupied homes in the applicable area;
3. The census tract must be located in a nonmetropolitan county and (i) have a median family income which does not exceed the median family income for the applicable area, and (ii) have been designated by a neighborhood homes credit agency; or
4. The census tract is located in a disaster area.¹⁹³

In the case of a metropolitan census tract, “applicable area” means the metropolitan area in which the census tract is located. In any other case, “applicable area” refers to the State in which the census tract is located. The proposal requires that the Secretary of Housing and Urban Development make publicly available a list of qualified census tracts each year.

The term “affordable sale” means a sale to a qualified homeowner of a qualified residence that (1) the agency certifies as meeting the standards promulgated by the agency (2) for a price that does not exceed (i) in the case of a house containing two residential units, an amount equal to five times the median family income for the applicable area; (ii) in the case of a house

¹⁹² Rules similar to the rules of section 143(f)(2) apply for determinations of family income.

¹⁹³ “Disaster area” is as defined in section 7508A(d)(3), but only with respect to any period for which the President of the United States has determined that the area warrants individual or individual and public assistance by the Federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

containing three residential units, an amount equal to six times the median family income for the applicable area; (iii) in the case of a house containing four residential units, an amount equal to seven times the median family income for the applicable area; or (iv) in the case of any qualified residence not described in (i), (ii), or (iii), an amount equal to four times the median family income for the applicable area. As discussed below, sales between related parties do not qualify as affordable sales.

The term “qualified homeowner” means an individual who owns and uses a qualified residence as the individual’s principal residence, and whose family income (determined as of the date that a binding contract for the affordable sale of the residence is entered into) is 140 percent or less of the median family income for the applicable area in which the residence is located. Qualified project means a project that a neighborhood homes credit agency certifies will build or substantially rehabilitate one or more qualified residences.

For purposes of the credit, dollar amounts are inflation adjusted, using calendar year 2021 as the base year.

Credit limitations

In general, the credit allowed to a taxpayer in a taxable year with respect to one or more qualified residences that are part of the same qualified project cannot exceed the excess (if any) of (1) the amount allocated by the agency to the taxpayer for the qualified project, over (2) the aggregate amount of credit previously allowed to the taxpayer for all prior taxable years.

No amount may be allowed with respect to any qualified residence unless, during the five-year period that begins on the date of the allocation to the qualified project of which the residence is a part, either the affordable sale or the substantial rehabilitation of the residence is completed (the “required five-year period”). If the required event does not occur within the required five-year period, the amount of the unallocated credit is returned to the State’s neighborhood homes credit ceiling, as discussed below.

Repayment rules, denial of rental deductions, and related party sales

Generally, if a qualified residence is sold during the five-year period that begins immediately after the affordable sale of the residence (the “repayment period”), the seller is required to transfer an amount equal to the repayment amount to the relevant neighborhood homes credit agency. The repayment amount is an amount equal to 50 percent of the gain from the sale, reduced by 20 percent for each year of the five-year period which has ended before the date of the sale. The agency may only use such repayment amounts for purposes of qualified projects. As discussed below, qualified rehabilitations of owner-occupied rehabilitations are subject to different repayment rules.

Neighborhood homes credit agencies must place a lien on each qualified residence that is built or rehabilitated as part of a qualified project for the amount that the agency deems is necessary to ensure potential repayment. However, an agency may waive repayment in the event that a homeowner is experiencing a hardship.

If, during the five-year period beginning after the affordable sale of a qualified residence, the owner of the qualified residence fails to use the residence as the owner's principal residence for any period of time, no deduction will be allowed for rental expenses paid or incurred by the owner with respect to renting the residence during this time period.

In general, a sale between related persons is not treated as an affordable sale. A related person is related to another person if the related person bears a relationship to the other person, or the related person and the other person are engaged in trades or businesses under common control.

Alternative rules and definitions for owner-occupied rehabilitations

The credit may also be provided to a taxpayer that rehabilitates certain owner-occupied residences. To be eligible, the taxpayer may not be the owner of the qualified residence or a related person with respect to the owner. For purposes of owner-occupied rehabilitations, certain alternative rules and definitions apply.

An alternative method of determining credit amounts is used for owner-occupied rehabilitations. For such rehabilitations, credit is allowed in the taxable year in which the qualified rehabilitation is completed, and the credit amount is equal to the least of (1) the excess (if any) of (i) the amounts paid or incurred by the taxpayer for the qualified rehabilitation of the qualified residence, to the extent the amounts are certified by the neighborhood homes credit agency (at the time of the completion of such rehabilitation) as meeting the standards promulgated by the agency, over (ii) any amounts paid to the taxpayer for the rehabilitation; (2) 50 percent of the amounts in (1)(i); or (3) \$50,000.

For purposes of owner-occupied rehabilitations, the term "qualified rehabilitation" means a rehabilitation performed pursuant to a written binding contract between the taxpayer and the qualified homeowner, if the amount paid or incurred by the taxpayer in the performance of the rehabilitation exceeds \$20,000. Substantial rehabilitation costs do not include any amount paid or incurred before the date on which an allocation is made to the taxpayer with respect to the qualified residence.

For purposes of owner-occupied rehabilitations, the term "qualified homeowner" means an individual (1) who owns and uses a qualified residence as the individual's principal residence, and (2) whose family income (determined as of the date that the binding contract between the taxpayer and homeowner is entered into) does not exceed the median family income for the applicable area in which the residence is located.

For purposes of owner-occupied rehabilitations, the term "qualified census tract" includes (1) any census tract which (i) has a median family income which does not exceed 80 percent of the median family income for the applicable area or has a poverty rate that is not less than 130

percent of the poverty rate of the applicable area, and (ii) is designated by the neighborhood homes credit agency; and (2) any census tract which is located in a disaster area.¹⁹⁴

For owner-occupied rehabilitations, the repayment period is the time period that (1) begins on the earlier of (i) the date that the owner enters into a binding contract for the performance of the rehabilitation or (ii) the date on which such rehabilitation begins, and (2) ends on the date that the rehabilitation is completed. This repayment period is in lieu of the five-year repayment period discussed above.

State neighborhood homes credit ceiling

For any calendar year, the aggregate amount allocated to qualified projects by the neighborhood homes credit agency of a State may not exceed the State neighborhood homes credit ceiling for such calendar year. Further, the credit allocated to any qualified project may not exceed the amount that the neighborhood homes credit agency determines (as of the date of the allocation) is necessary to ensure the financial feasibility of the qualified project.

The State neighborhood homes credit ceiling for a calendar year is an amount equal to the sum of (1) the greater of (i) \$6 multiplied by the State population or (ii) \$8,000,000, and (2) any amount previously allocated to a qualified project by the agency which can no longer be allocated to a qualified residence because the required five-year period expired during the calendar year.¹⁹⁵

In addition, the credit ceiling is increased by the excess (if any) of the State credit ceiling for the prior calendar year, over the aggregate amount allocated by the agency during the prior calendar year (such amount, a “carryforward”). The amount of carryforward does not carry past the third calendar year after the calendar year in which the credit amount originally arose, determined on a first-in, first-out basis.

Responsibilities of neighborhood homes credit agencies

The State neighborhood homes credit dollar amount is zero for a calendar year unless the neighborhood homes credit agency of the State (1) allocates the credit amount pursuant to a qualified allocation plan, (2) in the prior year, allocates not more than 20 percent of such amount to qualified residences which (i) are in certain qualified census tracts or (ii) are not located in qualified census tracts but meet certain requirements for pyrrhotite remediation, (3) promulgates standards with respect to reasonable qualified development costs and fees, (4) promulgates standards with respect to construction quality, (5) promulgates standards with respect to protecting the owners of owner-occupied residences, in the event of an owner-occupied

¹⁹⁴ “Disaster area” is as defined in section 7508A(d)(3), but only with respect to any period for which the President of the United States has determined that the area warrants individual or individual and public assistance by the Federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

¹⁹⁵ For example, if a qualified project has a required five-year period that expires in 2027, the credit that was previously allocated to the project would be included in the State credit ceiling for that year. Rules similar to the rules of section 42(h)(5) apply for purposes of determining the portion of the State credit ceiling set-aside for certain nonprofit organizations.

rehabilitation, with consideration to the ability of such owners to pay rehabilitation costs not covered by the credit and providing for the disclosure to owners of their rights and responsibilities, (6) and submits to the Secretary (at such time and in such manner as the Secretary may prescribe) an annual report.

Annual reports by neighborhood homes credit agencies must include the following information: (1) the amount of the credits allocated to each qualified project for the previous year, and (2) with respect to each qualified residence completed in the prior year, (i) the census tract in which such qualified residence is located, (ii) the year in which the qualified project including the qualified residence received an allocation, (iii) whether the qualified residence was new or substantially rehabilitated, (iv) the eligible basis of the qualified residence, (v) the amount of the credit with respect to the qualified residence, (vi) the sales price of the qualified residence, or, in the case of a substantially rehabilitated qualified residence, the cost of the substantial rehabilitation, (vii) the family income of the qualified homeowner (expressed as a percentage of the applicable area median family income for the location of the qualified residence), and (viii) such other information as the Secretary may require.

A qualified allocation plan is any plan which (1) sets forth the selection criteria to be used to prioritize qualified projects for allocations of State neighborhood homes credit dollar amounts, including (i) the need for new or substantially rehabilitated owner-occupied homes in the area addressed by the project, (ii) the expected contribution of the project to neighborhood stability and revitalization, (iii) the capability of the project sponsor, and (iv) the likelihood the project will result in long-term homeownership; (2) has been made available for public comment; and (3) provides a procedure that the neighborhood homes credit agency (or any agent or contractor of such agency) must follow for purposes of (i) identifying noncompliance with any provisions of this proposal and (ii) notifying the IRS of any such noncompliance of which the agency becomes aware.

The Secretary is required to produce an annual report, to be made available to the public, which contains the information in the annual reports submitted by neighborhood homes credit agencies discussed above. Any information made public must exclude any information that would allow for the identification of qualified homeowners.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2021.

H. Investments in Tribal Infrastructure

1. Treatment of Indian tribes as States with respect to bond issuance

Present Law

Treatment of Indian tribal governments as States for certain purposes

Section 7871 expressly provides that Indian tribal governments are treated as States for certain tax purposes. For example, tribal governments are extended the treatment provided to States in connection with any exemption from, credit or refund of, or payment with respect to the following excise taxes: tax on special motor fuels, manufacturers excise taxes, communications excise tax, and tax on use of certain highway vehicles.¹⁹⁶ Special treatment relating to excise taxes is available to tribal governments only with regard to transactions involving the exercise of an essential governmental function by the Indian tribal government. Section 7871(e) limits the term essential governmental function to exclude any function that is not customarily performed by State and local governments with general taxing powers.

Indian tribal governments are also treated as States in that they may issue tax-exempt bonds, subject to certain conditions described further below.

Tax-exempt bonds

In general

Under present law, gross income does not include interest on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons. For these purposes, the term “nongovernmental person” includes the Federal government and all other individuals and entities other than States or local governments. Interest on private activity bonds is taxable, unless the bonds are issued for certain purposes permitted by the Code and other requirements are met.

States may issue tax-exempt private activity bonds subject to a per-State volume cap. For calendar year 2021, the State volume cap, which is indexed for inflation, equals \$110 per resident of the State, or \$324,995,000, if greater.¹⁹⁷

¹⁹⁶ Sec. 7871(b).

¹⁹⁷ Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1022, November 9, 2020.

Issuance of tax-exempt bonds by Indian tribal governments

Indian tribal governments may issue tax-exempt bonds¹⁹⁸ in several types of circumstances if they meet requirements applicable to bonds issued by States and local governments as well as certain other rules applicable only to Indian tribal governments. Indian tribal governments may issue tax-exempt bonds for governmental purposes, subject to the requirement that substantially all of the proceeds of the issue are used in an essential governmental function, as discussed below.¹⁹⁹ Indian tribal governments also may issue private activity bonds but only for the purpose of financing manufacturing facilities.²⁰⁰

The Code provides that Indian tribal governments may also issue a third type of tax-exempt bond called “tribal economic development bonds” to finance projects and facilities (but not certain gambling facilities) if the bonds would be tax-exempt if issued by a State or local government.²⁰¹ The restriction of essential government function and the limitation on private activity bonds to certain manufacturing facilities do not apply. However, this Code provision is subject to an allocation limit of \$2 billion.

Governmental bonds

Like States and local governments, Indian tribal governments may issue so-called “governmental bonds.” These bonds are bonds the proceeds of which are primarily used to finance governmental facilities or which are repaid with governmental funds. The Code does not expressly define governmental bonds. Instead, bonds are generally treated as governmental bonds if they limit private involvement sufficiently to avoid classification as private activity bonds,²⁰² contain arbitrage restrictions,²⁰³ and satisfy bond registration and information reporting requirements and various other restrictions described in the Code.²⁰⁴

Indian tribal governments must meet an additional requirement to issue governmental bonds. Specifically, all bond proceeds must be used in an essential governmental function,²⁰⁵

¹⁹⁸ Generally, gross income does not include interest on State or local bonds. Sec. 103.

¹⁹⁹ Sec. 7871(c)(1).

²⁰⁰ Secs. 7871(c)(3), 103.

²⁰¹ The American Recovery and Reinvestment Act of 2009 (“ARRA”), Pub. L. No. 111-5, sec. 1402, added section 7871(f) to the Code.

²⁰² The exclusion from income of interest on State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain permitted purposes (“qualified private activity bonds”) and other Code requirements are met. Secs. 103, 141.

²⁰³ Secs. 103(b), 148.

²⁰⁴ Secs. 103(b), 149.

²⁰⁵ Sec. 7871(c)(1).

and such function must be customarily performed by State and local governments with general taxing powers.²⁰⁶

Private activity bonds for tribal manufacturing facilities

As with governmental bonds, Indian tribal governments are more restricted than States and local governments in their ability to issue private activity bonds. Section 7871(c)(3) permits tribal governments to issue private activity bonds²⁰⁷ so long as the bond proceeds are used for manufacturing facilities²⁰⁸ that are owned and operated by the tribal government on “qualified Indian lands,”²⁰⁹ and that employ tribal members.²¹⁰

A project financed by manufacturing facility bonds must meet requirements as to use, location and ownership, and employment. The use requirement provides that at least 95 percent of the net proceeds of the issue are to be used for the acquisition, construction, or improvement of property that is part of a manufacturing facility and subject to an allowance for depreciation. The location and ownership requirement provides that at least 95 percent of the net proceeds are to be used to finance property to be located on qualified Indian lands of the issuer, which is to be owned and operated by the issuer.²¹¹ At the time of issuance, it must be reasonably expected that the employment requirements will be met with respect to the facility financed by the bonds. As of the close of each calendar year in the testing period, the aggregate face amount of all outstanding tax-exempt bonds financing the facility cannot be more than 20 times greater than the aggregate wages paid during the preceding calendar year to enrolled members of the Indian tribe of the issuer (or spouse of such member) for services rendered. The employment requirement must be met each year beginning two years after the date of issuance. If the employment requirement is not met for any year for which it applies with respect to an issuance,

²⁰⁶ Sec. 7871(e).

²⁰⁷ Outside the Indian tribal government context, private activity bonds are generally bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons. For these purposes, the term “nongovernmental person” includes the Federal government and all other individuals and entities other than States or local governments. Interest on private activity bonds is taxable, unless the bonds are issued for certain purposes permitted by the Code and other requirements are met. Section 7871(c)(3)(C) provides that an obligation to which this paragraph (dealing with the exception for certain private activity bonds used for certain tribal manufacturing facilities) applies shall be treated as a private activity bond.

²⁰⁸ The term “manufacturing facility” is defined by cross reference to section 144(a)(12)(C) as any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property).

²⁰⁹ “Qualified Indian lands” means land which is held in trust by the United States for the benefit of an Indian tribe. The term “Indian tribe” means any Indian tribe, band, nation, or other organized group or community which is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians. Sec. 7871(c)(3)(E).

²¹⁰ Sec. 7871(c)(3)(D).

²¹¹ Tribes may jointly finance a manufacturing facility, and the employment test may be met in such case by *pro rata* apportionment of wages by tribe according to the relative participation of each tribe.

all bonds that are part of that issuance cease to be tax-exempt to their holders. The annual tribal employment test is in lieu of an annual aggregate volume limit.²¹²

Tribal economic development bonds

Indian tribal governments are also permitted to issue “tribal economic development bonds.”²¹³ A tribal economic development bond is any bond issued by an Indian tribal government (1) the interest on which would be tax-exempt if issued by a State or local government, and (2) that is designated by the Indian tribal government as a tribal economic development bond.²¹⁴

The aggregate face amount of bonds that may be designated by any Indian tribal government cannot exceed the amount of national tribal economic development bond limitation allocated to such government.²¹⁵ There is a national bond limitation of \$2 billion, allocated as the Secretary determines appropriate, in consultation with the Secretary of the Interior.²¹⁶ As of this writing, approximately \$58.7 million in volume limitation is available for allocation (subject to the forfeiture of unused volume limitation previously awarded).²¹⁷

Under the tribal economic development bond program, Indian tribal governments have the authority to issue bonds to finance projects and facilities owned by Indian tribes and located on Indian reservations, but outside the scope of “essential governmental function” bonds, such as convention centers, golf courses, hotels, restaurants, certain entertainment facilities, etc. In addition, Indian tribal governments have the authority to issue private activity bonds for any one

²¹² Manufacturing facility private activity bonds issued by tribes are not subject to State volume caps. See H.R. Conf. Rep. No. 100-495 (1987). Thus, the private activity bonds issued by tribes do not count against the volume cap of the State where the reservation is located. However, persons living on Indian reservations within a State are counted for purposes of calculating that State’s volume cap, thus, States could issue bonds for the benefit of tribal reservations located within the State.

²¹³ Sec. 7871(f).

²¹⁴ Sec. 7871(f)(3). Tribal economic development bonds issued by an Indian tribal government are treated as if such bonds were issued by a State except that section 146 (relating to State volume limitations) does not apply. Sec. 7871(f)(2).

²¹⁵ Sec. 7871(f)(3)(C).

²¹⁶ Sec. 7871(f)(1)(B). Announcement 2011-71, 2011-46 I.R.B. 770, November 14, 2011 (IRS sought comment from Indian tribal governments on the reallocation of available amounts of national bond volume limitation authority that were previously allocated and have been, or subsequently are, forfeited under Notice 2009-51, 2009-28 I.R.B. 128, July 13, 2009, and Announcement 2010-88, 2010-47 I.R.B. 753, November 22, 2010). In Notice 2012-48, 2012-31 I.R.B. 102, July 30, 2012, the Treasury department and IRS solicited applications for allocations of available volume cap (including amounts previously allocated and subsequently forfeited) and provided detailed guidance regarding the requirements for such applications and the method that will be used to allocate volume cap.

²¹⁷ See [https://www.irs.gov/tax-exempt-bonds/published-volume-cap-limit-for-tribal-economic-development-bonds#:~:text=The%20Published%20Volume%20Cap%20Limit,or%20\(2\)%20%24100%2C000%2C000](https://www.irs.gov/tax-exempt-bonds/published-volume-cap-limit-for-tribal-economic-development-bonds#:~:text=The%20Published%20Volume%20Cap%20Limit,or%20(2)%20%24100%2C000%2C000) (as of August 1, 2021).

of the seven types of “qualified bonds” used for purposes that Congress has permitted²¹⁸ and are not limited to financing tribal manufacturing facilities. The six other types of qualified private activity bonds include (1) exempt facility bonds;²¹⁹ (2) qualified mortgage bonds²²⁰ to finance the purchase or repair or rehabilitation of owner-occupied single-family homes located in the jurisdiction of the issuer; (3) qualified veteran’s mortgage bonds²²¹ to finance veterans’ purchases of owner-occupied single-family homes (as long as a State issued such bonds before June 22, 1984); (4) qualified student loan bonds;²²² (5) qualified redevelopment bonds²²³ to finance the redevelopment of blighted areas; and (6) qualified 501(c)(3) bonds²²⁴ to fund the exempt activities of a section 501(c)(3) organization.

Tribal economic development bonds cannot be used to finance any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted, or housed, or any other property used in the conduct of such gaming. Nor can tribal economic development bonds be used to finance any facility located outside of the Indian reservation.²²⁵

Description of Proposal

The proposal allows Indian tribal governments to issue governmental bonds and private activity bonds on a basis similar to State and local governments, but with certain location and gambling facility restrictions applicable to private activity bonds.

First, under the proposal, the essential governmental function standard does not apply to the issuance of tax-exempt bonds by Indian tribal governments.

²¹⁸ Sec. 141(e) (provides the list of seven categories of qualified private activity bonds). For purposes of tribal economic development bonds, use of bond proceeds by an Indian tribe, or instrumentality thereof, is treated as use by a State. Sec. 7871(f)(2)(B).

²¹⁹ Sec. 142. Business facilities eligible for this financing include transportation (airports, ports, local mass commuting, high-speed intercity rail facilities, and qualified highway or surface freight transfer facilities); privately owned and/or operated public works facilities (sewage, solid waste disposal, water, local district heating or cooling, and hazardous waste disposal facilities); privately-owned and/or operated residential rental housing; and certain private facilities for the local furnishing of electricity or gas. Bonds issued to finance “environmental enhancements of hydro-electric generating facilities,” qualified public educational facilities, and qualified green building and sustainable design projects also may qualify as exempt facility bonds.

²²⁰ Sec. 143.

²²¹ Sec. 143. Sec. 142(l)(2).

²²² Sec. 144(b).

²²³ Sec. 144(c).

²²⁴ Sec. 145.

²²⁵ Sec. 7871(f)(3)(B).

Second, for private activity bonds, the proposal requires the Secretary annually to establish a national Tribal private activity bond volume cap for all Indian tribes based on the greater of (1) the State population formula approach in section 146(d)(1)(A) (using national tribal population estimates supplied annually by the Department of the Interior in consultation with the Census Bureau), and (2) the minimum State ceiling amount in section 146(d)(1)(B) (as adjusted for the cost of living). The Secretary also is required annually to allocate the national bond volume cap among Indian tribal governments seeking an allocation in a particular year under regulations prescribed by the Secretary. The present-law limits on using State volume cap to finance a facility located outside of the State (section 146(k)(1)) do not apply to volume cap allocated under the proposal to the extent that such cap is used with respect to financing for a facility located on qualified Indian lands.

No portion of volume cap allocated to an Indian tribal government under the proposal may be used with respect to the financing of any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted or housed or any property actually used in the conduct of such gaming.

There is no volume cap for governmental bonds issued by an Indian tribal government.

For purposes of the proposal, the term “Indian tribal government” means the governing body of an Indian tribe, band, nation, or other organized group or community, or of Alaska Natives, which is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians. The term “Indian tribal government” also includes any agencies, instrumentalities, or political subdivisions thereof. The term “qualified Indian lands” means an Indian reservation as defined in section 3(d) of the Indian Financing Act of 1974,²²⁶ including lands that are within the jurisdictional area of an Oklahoma Indian tribe (as determined by the Secretary of the Interior). The term “qualified Indian lands” also includes lands outside a reservation where the facility is to be placed in service in connection with (1) the active conduct of a trade or business by an Indian tribe on, contiguous to, within reasonable proximity of, or with a substantial connection to, an Indian reservation or Alaska Native village, or (2) infrastructure (including roads, power lines, water systems, railroad spurs, and communication facilities) serving an Indian reservation or Alaska Native village.

The proposal includes a special rule for situations where an Indian tribal government has authorized an intertribal consortium, a Tribal organization, or an Alaska Native regional or village corporation²²⁷ to plan for, coordinate, or otherwise administer services, finances, functions, or activities on its behalf. In such cases, the authorized entity shall have the rights and responsibilities of the authorizing Indian tribal government only to the extent provided in the authorizing resolution.

²²⁶ 25 U.S. C. 1452(d).

²²⁷ As defined in, or established pursuant to, the Alaska Native Claims Settlement Act.

Effective Date

The proposal is effective for obligations issued in calendar years beginning after the date of enactment.

2. New markets tax credit for Tribal Statistical Areas

Present Law

New Markets Tax Credit

In general

The New Markets Tax Credit (“NMTC”) is a geography-based tax credit program. Under section 45D(a), an investor may claim tax credits for a qualified equity investment in a qualified community development entity (“CDE”). The qualified CDE designates equity investments as qualified equity investments, rendering the investor eligible to receive tax credits. The qualified CDE can only designate up to an amount allocated to it by the Department of the Treasury’s Community Development Financial Institutions Fund (“CDFI Fund”). The CDFI Fund annually allocates NMTCs to CDEs under a competitive application process.

Qualifying geography

The NMTC provisions require CDEs to serve or provide investment capital for low-income communities or low-income persons. A low-income community is either (1) a population census tract that meets certain criteria or (2) a specific area designated by the Secretary. Specifically, a “low-income community” is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a nonmetropolitan census tract, generally does not exceed 80 percent of statewide median family income).

CDEs may also qualify for the NMTC if they serve targeted populations, as designated by the Secretary, regardless of the composition of the population census tract or tracts in which the targeted populations live. Under this rule, the targeted population is treated as a low-income census tract. For this purpose, a “targeted population” is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (the “Act”) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that “low-income” means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a nonmetropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide nonmetropolitan area median family income.

Allocation process

The CDFI Fund annually allocates NMTCs to CDEs under a competitive application process. CDEs, in turn, allocate NMTCs to equity investors. The maximum annual amount of NMTCs that the CDFI Fund can allocate is \$3.5 billion for calendar years 2010 through 2019 and \$5 billion for calendar years from 2020 through 2025. No amount of unused allocation limitation may be carried to any calendar year after 2030.

In general, there is no set aside of any portion of the allocation limitation to a subset of low-income communities. However, Congress has allocated specific amounts to areas affected by certain natural disasters.²²⁸ In addition, the CDFI Fund is required to assure that non-metropolitan counties receive a proportional allocation of the limitation.²²⁹

Applicability of the NMTC for projects in Native American areas

The NMTC provisions require CDEs to serve or provide investment capital for low-income communities. CDEs formed to support Native American projects may satisfy this requirement in two ways.

First, the CDE may invest in a project in a population census tract designated as a low-income community; a population census tract in a Native American area²³⁰ can qualify as a “low-income community.” Second, the CDE may invest in a project that serves a targeted population, as designated by the Secretary. Targeted populations are treated as low-income communities regardless of the composition of the population census tract or tracts in which the targeted population lives.²³¹ Certain Indian tribes are included in the list of groups that may be designated as targeted populations.²³²

²²⁸ See Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135, sec. 101, December 21, 2005 (allocated an additional \$1 billion of credits over a period of three years for qualified areas affected by Hurricane Katrina).

²²⁹ Sec. 45(i)(6).

²³⁰ “Native American area” is the term used by the U.S. Department of Treasury, CDFI Fund, Office of Financial Strategies and Research to describe land designated as Indian reservations by Federal or State authorities. These areas are composed of U.S. Census Bureau “American Indian/Alaska Native/Native Hawaiian Areas,” available at <https://catalog.data.gov/dataset/tiger-line-shapefile-2018-nation-u-s-current-american-indian-alaska-native-native-hawaiian-area> (last visited May 14, 2021).

²³¹ Sec. 45D(e)(2).

²³² Sec. 45D(e)(2); 12 U.S.C. sec. 4702(20); see also Treas. Reg. 1.45D-1(d)(9). An Indian tribe may be designated as a targeted population if the tribe are (i) low income persons or (ii) otherwise lack a dequate access to loans or equity investments. 12 U.S.C. sec. 4702(20). A targeted population is “low-income” for this purpose if (1) in the case of a metropolitan area, the group’s median family income does not exceed 80 percent of the area median family income, or (2) in the case of a non-metropolitan area, the group’s median family income does not exceed 80 percent of either area median family income or statewide nonmetropolitan area median family income. 12 U.S.C. sec. 4702(17); Treas. Reg. sec. 1.45D-1(d)(9).

Tribal and other census designations

The United States Census Bureau has several designations for tribal and other areas.²³³ Tribal Census Tracts are areas within Federally recognized American Indian reservations and off-reservation trust land areas. Tribal Designated Statistical Areas are areas relating to Federally recognized American Indian tribes that do not currently have a federally recognized land base. Oklahoma Tribal Statistical Areas are areas relating to Federally recognized American Indian tribes based in Oklahoma. Alaska Native Village Statistical Areas are areas that represent a portion of Alaska Native villages. Hawaiian Home Lands are areas held in trust for Native Hawaiians by the state of Hawaii, pursuant to the Hawaiian Homes Commission Act of 1920, as amended.²³⁴

Description of Proposal

The proposal broadens the definition of low-income community to include an area used for a project which services a significant population of Tribal or Alaska Native Village members who are residents of a low-income community. This tribal population rule only applies if the relevant Indian Tribal government, within the meaning of section 7871(c),²³⁵ documents the eligibility of such project.

In addition, beginning in 2022, the proposal provides an additional allocation limitation of NMTC of \$175 million, which may be allocated only with respect to low-income communities that are Tribal Statistical Areas. Low-income communities that are Tribal Statistical Areas remain eligible for the general allocation limitation. For calendar years after 2024, the \$175 million amount is indexed to inflation.

Unused additional allocation limitation for low-income communities that are Tribal Statistical Areas increases the additional allocation limitation in the subsequent year. Thus, for example, if \$10 million in additional allocation limitation is not used in calendar year 2022, the additional allocation limitation in 2023 is increased by the \$10 million. However, if unused additional allocation limitation is carried over unused for five calendar years, on the sixth calendar year it increases the general allocation limitation.

A low-income community that is a Tribal Statistical Area is any low-income community located in any Tribal Census Tract, Oklahoma Tribal Statistical Area, Tribal-Designated

²³³ See generally U.S. Census Bureau, TIGERweb Geography, American Indian, Alaska Native, and Native Hawaiian Areas, *available at* https://tigerweb.geo.census.gov/tigerwebmain/TIGERweb_geography_details.html (last accessed August 26, 2021); U.S. Census Bureau, Tribal Glossary, *available at* https://www.census.gov/tribal/tribal_glossary.php (last accessed August 26, 2021).

²³⁴ *Ibid.* See also Hawaiian Homes Commission Act, 1920, 42 Stat. 108, *et seq.*

²³⁵ Under section 7871(c), as amended by this bill, an Indian Tribal government means the governing body of an Indian Tribe, band, nation, or other organized group or community, or of Alaska Natives, which is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians, and also includes any agencies, instrumentalities or political subdivisions thereof.

Statistical Area, Alaska Native Village Statistical Area, or Hawaiian Home Land. It also includes low-income communities that are areas used for projects which service a significant population of tribal, Hawaiian Home Land, or Alaska Native Village members.

Effective Date

The proposal applies to the new markets tax credit limitation determination for calendar years after December 31, 2021.

3. Inclusion of Indian areas as difficult development areas for purposes of certain buildings

Present Law

A taxpayer may claim the low-income housing tax credit annually over a 10-year period for the costs of building or rehabilitating rental housing occupied by low-income tenants. The amount of credit that may be claimed each year is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.²³⁶

Credit calculations

Determination of applicable percentage

The applicable percentage for non-Federally subsidized newly constructed housing and non-Federally subsidized substantial rehabilitation is calculated such that the present value of the credit amounts is at least 70 percent of a building's qualified basis, depending on the prevailing interest rate.²³⁷ These credits are sometimes referred to as "nine-percent credits."

The applicable percentage for Federally subsidized newly constructed housing, Federally subsidized substantial rehabilitation, and certain housing acquisition costs, is calculated such that the present value of the credit amounts is at least 30 percent of a building's qualified basis, depending on the prevailing interest rate.²³⁸ These credits are sometimes referred to as "four-percent credits."

²³⁶ Sec. 42.

²³⁷ See sec. 42(b) and (e). This credit is referred to as the 70-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Housing and Economic Recovery Act of 2008, the minimum applicable percentage for such credits was temporarily set at nine percent (the "nine-percent floor"). The Consolidated Appropriations Act, 2016 made the nine-percent floor permanent. The enactment of the nine-percent floor on the credit implies that, under the statutory formula, the present value is always 70 percent or greater.

²³⁸ This credit is referred to as the 30-percent credit. See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987. This document can be found on the Joint Committee on Taxation website at www.jct.gov. However, under the Consolidated Appropriations Act, 2020, the minimum applicable percentage for such credits was set at four percent (the "four-percent floor"). The enactment of the four-percent floor on the credit implies that, under the statutory formula, the present value is always 30 percent or greater.

Calculation of eligible basis

The qualified basis for purposes of determining the amount of low-income housing credit to be claimed each year is an amount equal to the applicable fraction of eligible basis.²³⁹ The eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period. The eligible basis of an existing building is zero unless the building meets the following requirements: the building is acquired by purchase; there is a period of at least 10 years between the date of its acquisition by the taxpayer and the date the building was last placed in service; the building was not previously placed in service by the taxpayer or a related person; and the building was rehabilitated and is eligible for the low income housing credit for rehabilitation expenditures treated as a separate new building.

Generally, buildings located in high cost areas are eligible for enhanced low-income housing tax credit, which is effectuated by increasing such buildings' eligible basis or the rehabilitation expenditures taken into account for purposes of the credit. For this purpose, qualified census tracts and difficult development areas are treated as high cost areas.²⁴⁰ A qualified census tract is a census tract designated by the Secretary of Housing and Urban Development in which 50 percent or more of households have an income of less than 60 percent of area median gross income, or which has a poverty rate of at least 25 percent. A difficult development area is an area designated by the Secretary of Housing and Urban Development in which construction, land, or utility costs are high relative to area median gross income.

In the case of a new building located in a qualified census tract or difficult development area, the eligible basis is increased to 130 percent of such basis calculated without regard to this increase. In the case of a substantial rehabilitation to an existing building, the rehabilitation expenditures taken into account are increased to 130 percent of such expenditures calculated without regard to this increase.

Indian areas

Present law does not require housing credit agencies to allocate credits to projects located in Native American areas.²⁴¹ However, agencies are allowed to give preference in allocating credits to projects serving the lowest-income tenants and to set project selection criteria that reflect the housing priorities of the agency and are appropriate to local conditions.²⁴²

²³⁹ Sec. 42(c)(1)(A).

²⁴⁰ Sec. 42(d)(5)(B).

²⁴¹ The term "Native American area" refers to Federal- and State-designated Native American areas, off-reservation trust lands, Hawaiian home lands, State-designated tribal statistical areas, tribal designated statistical areas, Oklahoma tribal statistical areas, and Alaskan Native village statistical areas. See Census Bureau, *Class Codes and Definitions*, available at <https://www.census.gov/library/reference/code-lists/class-codes.html>; Census Bureau, *TIGER/Line Shapefile, 2017, nation, U.S., Current American Indian/Alaska Native/Native Hawaiian Areas National (AIANNH) National*, October 17, 2019, available at <https://catalog.data.gov/dataset/tiger-line-shapefile-2017-nation-u-s-current-american-indian-alaska-native-native-hawaiian-area>.

²⁴² Sec. 42(m)(1).

Depending on the rules of the particular State or locality, a Native American tribe may be involved in a low-income housing tax credit project in various ways. For example, an applicant for housing credits may be required to obtain legal authorization or permits from a tribal government for a project that is located on land controlled by the tribe. A tribe may also be more directly involved and serve as the lender, developer, or property manager for a project.²⁴³

Description of Proposal

The proposal amends the definition of difficult development area to include any Indian area for the purpose of determining eligible basis. An Indian area is defined to be an area in which a Federally recognized tribe or a State recognized tribe (“Indian tribe”), or a tribally designated housing entity that is authorized by one or more Indian tribes provides assistance for affordable housing, including permanent housing for homeless persons with disabilities, transitional housing, and single room occupancy housing.²⁴⁴ A tribally designated housing entity may include existing Indian housing authorities as well as other entities that provide assistance for affordable housing for Indians.

In the case of an area which is a difficult development area solely because it is an Indian area, a building is not considered to be located in a difficult development area for the purpose of determining eligible basis unless the building is financed under the Native American Housing Assistance and Self Determination Act of 1996,²⁴⁵ sponsored by an Indian tribe or a tribally designated housing entity, or wholly owned or controlled by an Indian tribe or a tribally designated housing entity.

Effective Date

The proposal applies to buildings placed in service after December 31, 2021.

²⁴³ For more detailed information regarding projects located on Native American lands, see Joint Committee on Taxation, *Overview of Federal Tax Provisions and Analysis of Selected Issues Relating to Native American Tribes and Their Members* (JCX-8-20), February 28, 2020, pp. 49-51. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

²⁴⁴ 25 U.S.C. 4103.

²⁴⁵ 25 U.S.C. 4101 et seq.

I. Investments in the Territories

1. Possessions economic activity credit

Present Law

Federal tax rules apply to the possessions in a manner that is different from their application in relation to both the States and foreign countries. Broadly, an individual resident of a possession is exempt from U.S. tax on income that has a source in that possession but is subject to U.S. tax on U.S.-source and non-possession-source income. A corporation that is organized in a possession is generally treated as a foreign corporation for U.S. tax purposes. On the other hand, a number of Code provisions have effect in one or all of the territories as if the territories were States. For example, the tax credit for research and experimentation has been available for research conducted in a possession.

Historically, the Federal tax rules also have included preferences for possession activities. Until its expiration in 2006, the section 936 possession tax credit permitted qualifying U.S. corporations a credit against their U.S. tax liability in respect of possession-source income.²⁴⁶ After section 936 expired, a similar, a temporary provision was enacted for American Samoa activities,²⁴⁷ and the section 199 domestic production activities deduction was expanded temporarily to include production activities conducted in Puerto Rico. The latter has since

²⁴⁶ For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b) and 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporate taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936. Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit was phased out during the 10-year period starting in 1996. During this phase-out period, the Puerto Rico economic activity credit of section 30A was available for trade or business activity in Puerto Rico.

²⁴⁷ Section 199 was repealed for taxable years beginning after December 31, 2017, by "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Pub. L. No. 115-97 (the "2017 Act"), section 13305.

expired.²⁴⁸ At present, there is no economic development credit in the Code applicable only to activities in the U.S. possessions. The credit for American Samoa activities remains in effect for taxable years ending before January 1, 2022.²⁴⁹

The credit applicable to activities in American Samoa was first enacted in 2006. The credit is not part of the Code but is computed based on the rules of former sections 30A, 199, and 936. For purposes of this credit, the Code is applied without regard to the repeal of sections 30A and 936 in 2018,²⁵⁰ or the repeal of section 199 in 2017.²⁵¹

For taxable years beginning before January 1, 2011, as originally enacted, the credit was limited to domestic corporations that were existing credit claimants with respect to American Samoa who had elected the application of section 936 for its last taxable year beginning before January 1, 2006. The credit is based on the corporation's economic activity-based limitation with respect to American Samoa. An existing claimant is a domestic corporation that (1) was engaged in the active conduct of a trade or business within American Samoa on October 13, 1995, and (2) elected the benefits of the possession tax credit in an election in effect for its taxable year that included October 13, 1995, or that acquired all of the assets of a trade or business that met the foregoing conditions. A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

²⁴⁸ Sec. 199(d)(8).

²⁴⁹ This credit was again extended during the 116th Congress by section 139 of the Taxpayer Certainty and Disaster Relief Act of 2020 (Division EE of the "Consolidated Appropriations Act, 2021," Pub. L. No. 116-260).

²⁵⁰ The Consolidated Appropriations Act 2018, Pub. L. No. 115-141, Division U, Title IV, at sec. 401(d)(1)(C) (the repeal of section 936) and sec. 401(d)(1)(D)(viii)(I) (definition of intangible property added to section 367(d)) (March 23, 2018).

²⁵¹ Pub. L. No. 115-97, sec. 13305(a).

The rule denying a credit or deduction for any possessions tax or foreign tax paid with respect to taxable income that is taken into account in computing the credit under section 936²⁵² does not apply with respect to the credit allowed by this provision.

For taxable years beginning after December 31, 2011, the credit rules are modified in two ways. First, domestic corporations with operations in American Samoa are allowed the credit even if those corporations are not existing credit claimants. Second, the credit is available to a domestic corporation (either an existing credit claimant or a new credit claimant) only if the corporation has qualified production activities income (as defined in section 199(c) by substituting “American Samoa” for “the United States” in each place that the latter term appears).

In the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, the credit applies to the first 16 taxable years of the corporation which begin after December 31, 2005, and before January 1, 2022. For any other corporation, the credit applies to the first ten taxable years of that corporation which begin after December 31, 2011, and before January 1, 2022.

Description of Proposal

The provision creates a new economic activity credit related to active businesses conducted in U.S. possession or possessions. The new credit is a general business credit equal to 20 percent of for wages the sum of qualified possessions wages and fringe benefits paid or incurred by a qualified domestic corporation for a taxable year. For purposes of this credit, “possessions” include the [five] fiscally autonomous territories of American Samoa, Guam, Commonwealth of Northern Marianas, Commonwealth of Puerto Rico, and the U.S. Virgin Islands.

“Qualified domestic corporation” encompasses both U.S. corporations and a U.S. shareholder of a foreign qualified corporation that is wholly owned by the same US group if they meet both source of income and active conduct of trade or business tests.

The source of income test requires that the qualified corporation have received 80 percent or more of its income from sources within a possession of the United States for a three-year period that precedes the close of the year for which the credit is claimed. Where applicable, a shorter period ending on the close of the taxable year may be used for the test period. The amount is determined without regard to the rules for determining overall foreign losses under the foreign tax credit limitation rules of section 904(f).

The trade or business test also looks to the three-year period preceding the close of the taxable year. During that period, at least 75 percent of gross income of the corporation must be derived from the active conduct of a trade or business in the possession.

²⁵² See sec. 936(c).

Qualified possessions wages are defined as wages paid as part of the active conduct of a trade or business in a possession to an employee whose principal place of employment is the in the possession and whose services were in fact performed in a possession. The amount of wages per employee that may be taken into account as qualified possessions wages is limited to \$50,000. If an employee is part-time or performs such services outside the possession, the amount of wages eligible for the credit are reduced accordingly. Wages paid to an employee for services performed for another party are ineligible, unless the business of the taxpayer is providing temporary employees for others.

Allocable employee fringe benefits are also taken into account in determining the credit. The portion of fringe benefits allocable to possession wages is the amount of that bears the same proportion to total fringe benefits as the amount of possession wages bears to total wages paid by the qualified domestic corporation, up to 15 percent of the amount of qualified possession wages. In determining the employee fringe benefits, expenses for employer contributions to certain retirement or profit-sharing funds and for health benefits to employees are taken into account.

Effective Date

The proposal is generally effective for taxable years beginning after date of enactment. For qualified corporations that are foreign corporations, the proposal is effective for taxable years beginning after date of enactment and to the taxable year of United States shareholders that includes the date on which such taxable year of the foreign corporation ends.

2. Additional new markets tax credit allocations for the territories

Present Law

New markets tax credit

In general

The New Markets Tax Credit (“NMTC”) is a geography-based tax credit program. Under section 45D(a), an investor may claim tax credits for a qualified equity investment in a qualified community development entity (“CDE”). The qualified CDE designates equity investments as qualified equity investments, rendering the investor eligible to receive tax credits. The qualified CDE can only designate up to an amount allocated to it by the Department of the Treasury’s Community Development Financial Institutions Fund (“CDFI Fund”). The CDFI Fund annually allocates NMTCs to CDEs under a competitive application process.

Qualifying geography

The NMTC provisions require CDEs to serve or provide investment capital for low-income communities or low-income persons. A low-income community is either (1) a population census tract that meets certain criteria or (2) a specific area designated by the Secretary. Specifically, a “low-income community” is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a nonmetropolitan census tract, generally does not exceed 80 percent of statewide median

family income). For population census tracts within the U.S. territories, this definition is applied using possession-wide median family income.

CDEs may also qualify for the NMTC if they serve targeted populations, as designated by the Secretary, regardless of the composition of the population census tract or tracts in which the targeted populations live. Under this rule, the targeted population is treated as a low-income census tract. For this purpose, a “targeted population” is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (the “Act”) to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that “low-income” means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a nonmetropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide nonmetropolitan area median family income.

Allocation process

The CDFI Fund annually allocates NMTCs to CDEs under a competitive application process. CDEs, in turn, allocate NMTCs to equity investors. The maximum annual amount of NMTCs that the CDFI Fund can allocate is \$3.5 billion for calendar years 2010 through 2019 and \$5 billion for calendar years from 2020 through 2025. No amount of unused allocation limitation may be carried to any calendar year after 2030.

In general, there is no set aside of any portion of the allocation limitation to a subset of low-income communities. However, Congress has allocated specific amounts to areas affected by certain natural disasters.²⁵³ In addition, the CDFI Fund must assure that non-metropolitan counties receive a proportional allocation of the limitation.²⁵⁴

U.S. Territories

Citizens of the United States are generally subject to Federal income tax on their U.S. and foreign income regardless of whether they live in a State, a foreign country, or a U.S. territory. Residents of the five U.S. territories²⁵⁵ are generally subject to the Federal income tax system based on their status as U.S. citizens or residents of the territories, with certain special rules for determining residence and source of income specific to the territory. Broadly, a bona fide individual resident of a territory is exempt from U.S. tax on income derived from sources within that territory but is subject to U.S. tax on U.S.-source and non-territory-source income.²⁵⁶ A

²⁵³ See Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135, sec. 101, December 21, 2005 (allocated an additional \$1 billion of credits over a period of three years for qualified areas affected by Hurricane Katrina).

²⁵⁴ See sec. 45(i)(6).

²⁵⁵ The Code refers to the territories as “possessions.”

²⁵⁶ See secs. 932, 933, and 937; see also former sec. 935 (1986), which remains in effect pursuant to the Tax Reform Act of 1986, Pub. L. No. 99-514, sec. 1277(b), October 22, 1986; 48 U.S.C. sec. 1801 note, sec. 601.

bona fide resident of a territory for a taxable year is generally an individual (1) who is present for at least 183 days during the taxable year in the territory, and (2) who does not have either a tax home outside the territory or a closer connection to the United States or a foreign country than to the territory.²⁵⁷

The application of the Federal tax rules to the territories varies from one territory to another. Three territories—Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands—are referred to as mirror Code territories because the Code serves as the internal tax law of those territories (substituting the particular territory for the United States wherever the Code refers to the United States).²⁵⁸ Thus, there is a mirror Code version of the child and dependent care tax credit under the internal revenue laws of each mirror Code territory. A resident of one of those territories generally files a single tax return only with the territory of which the individual is a resident, and not with the United States.²⁵⁹

American Samoa and Puerto Rico, by contrast, are non-mirror Code territories. These two territories have their own internal tax laws, and a resident of either American Samoa or Puerto Rico may be required to file income tax returns with both their territory of residence and the United States.

For purposes of the NMTC, low-income communities include population census tracts and targeted populations in the U.S. territories. Thus, taxpayers subject to U.S. tax may claim the NMTC for qualifying investments in projects in the territories.

Description of Proposal

Beginning in 2022, the proposal provides an additional allocation limitation of NMTC of \$80 million, which may be allocated only with respect to low-income communities located in Puerto Rico. The proposal also provides an additional allocation limitation of NMTC of \$20 million, which may be allocated only with respect to low-income communities located in the territories of Guam, the Commonwealth of the Northern Marian Islands, the U.S. Virgin Islands, or American Samoa. Low-income communities in the territories remain eligible for the general allocation limitation.

For calendar years after 2024, the \$80 million and \$20 million amounts are indexed to inflation.

Unused additional allocation limitation for either Puerto Rico or the other territories increases the respective additional allocation limitation in the subsequent year. Thus, for example, if \$10 million in additional allocation limitation for Puerto Rico is not used in calendar year 2022, the additional allocation limitation for Puerto Rico in 2023 is increased by the \$10

²⁵⁷ Sec. 937.

²⁵⁸ 48 U.S.C. sec. 1397 (U.S. Virgin Islands); 48 U.S.C. sec. 1421i (Guam); 48 U.S.C. 1801 note, sec. 601 (Commonwealth of the Northern Mariana Islands).

²⁵⁹ Sec. 932 and former sec. 935.

million. However, if unused additional allocation limitation is carried over unused for five calendar years, on the sixth calendar year it increases the general allocation limitation.

Effective Date

The proposal is effective for calendar years after 2021.