Strategic Treasurer
Consultants in Treasury

Monarch Private Capital

Mitigating Tax Liability

Primer on Tax Equity Investments & Tax Credits for Treasury

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Today's Presenters

Craig Jeffery, CCM, FLMI

Founder & Managing Partner

Strategic Treasurer

Craig Jeffery formed Strategic Treasurer LLC in 2004 to provide corporate, educational, and government entities direct access to comprehensive and current assistance with their treasury and financial process needs. His 20+ years of financial and treasury experience as a practitioner and as a consultant have uniquely qualified him to help organizations craft realistic goals and achieve significant benefits quickly.

George L. Strobel II

Co-CEO, Managing Director of Tax Credit Investments

Monarch Private Capital

George Strobel works with tax credit purchasers and their advisors to identify the most appropriate tax credit offering. George's depth of experience and thorough understanding of the tax credit market as well as federal and state regulations ensures that buyers satisfy their tax liability objectives. He is a certified public accountant in three states and the Co-founder and Managing Director of Perigee Group, a boutique consultancy firm that provides investment, tax, estate and succession planning for high net worth individuals throughout the United States.

Topics of Discussion

Treasury's Stake in Taxes

Who Cares About Taxes?

The **Tax Department** will typically be responsible for generating tax statements, ensuring compliance with tax-related legislation, and strategic considerations like repatriation.

Accounting's primary considerations with taxes involve ensuring compliance of financial statements with GAAP and other regulations and providing accurate financial reports.

For **Treasury**, tax-related responsibilities center around the facilitation of bank statements and reports to develop financial statements, managing cash pooling structures, and strategically positioning cash, repatriating funds, etc.

Treasury's Role with Taxes

Manage Transaction & Payment Activity

As treasury usually manages payments and are the designated authorities over the company's bank accounts, any reporting workflows regarding transactions and bank statements typically pass through treasury.

Strategic Cash Positioning

In order to lessen their organization's tax burden without breaking compliance with known statutes or laws, accounting and legal may work closely with treasury to strategically position cash and other assets so that taxable income is reduced.

Cash Repatriation

Treasury's role in this arena has been brought into the spotlight within the past year as the U.S. repatriation holiday went into effect and many companies brought millions and even billions of dollars back into America at a reduced rate.

Strategic Tax Mitigation

In certain circumstances, treasury can invest in tax equity instruments or in special projects to receive tax credits. These tax-related opportunities can offer the chance for treasury to reduce their tax liability and even generate returns above what is available through other market investments.

Tax Responsibilities Across Departments

Tax

- Prepare Tax Statements
- Strategic considerations to reduce taxable income
- Ensure Clear Audit Trails
- Ensure Compliance with Tax Legislation
- Goal: Auditability & Transparency

Accounting

- Manage Financial Reporting
- Document & Record Transactions
- Ensure Compliance with GAAP
- Goal: Accurate Financial Statements & Classification of Cash Flows

Treasury

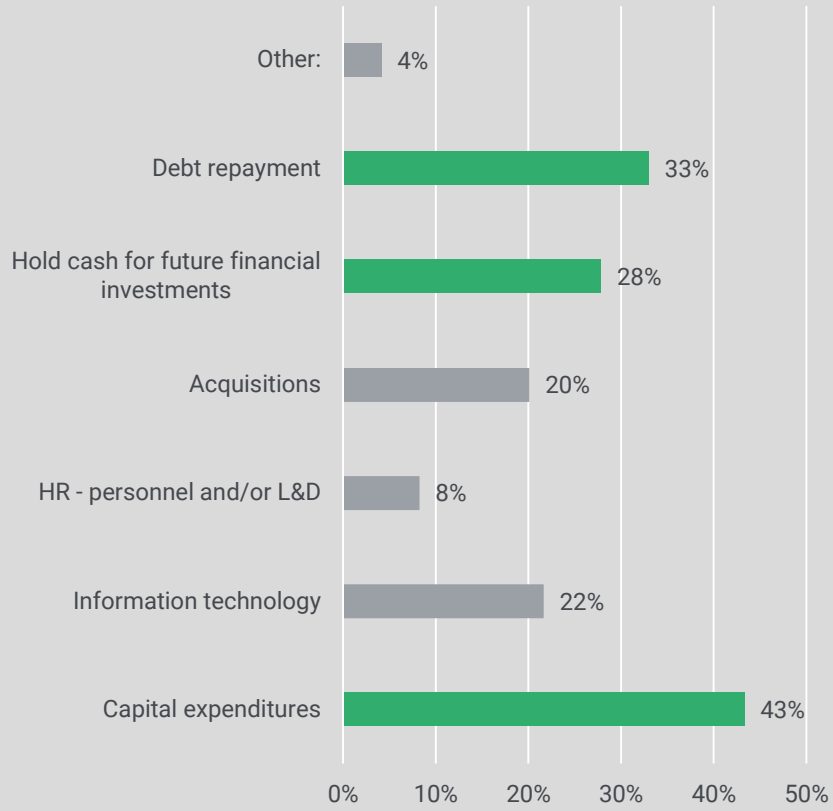
- Steward Payments Activity
- Optimize Liquidity & Working Capital
- Manage Global Cash Positions to Maintain Ideal Tax Structure
- Goal: Financial Asset Optimization & Control

Tax Considerations for Strategic Investing

Which of the following best describes your balance sheet for working capital requirements?

2018 Strategic Treasurer, Bottomline Technologies, & Bank of America Merrill Lynch B2B Payments & WCM Strategies Survey

Corporates: Where do you anticipate allocating most of your excess cash? (*Select no more than two*)



2017 Strategic Treasurer & TD Bank Treasury Perspectives Survey

Tax Considerations for Strategic Investing, Cont'd

Landscape of Tax Optimization Strategies

Overseas Holdings & Strategic Repatriation

Overseas holdings simply refer to company assets purposefully held outside of the U.S. or domestic country in order to avoid repatriation taxes.

Strategic repatriation involves taking advantage of tax holidays or other circumstances where tax rates for repatriated funds are reduced.

Example: 2018 tax holiday saw billions of dollars repatriated into the U.S.

Trademark Holding Companies

Holding companies are created for the sole purpose of holding an ownership stake in another firm's assets, rather than offering any products or services of their own.

Holding companies effectively limit financial/legal liabilities of certain entities and can also reduce tax liability by basing components of the business in regions with lower tax rates.

Charitable Contribution / Donations for Deductions

Donating to non-profits and other charitable organizations provides companies with a tax deduction.

These deductions ultimately reduce the amount of taxable income for the company.

Charitable contributions also serve to foster positive public relations and promote corporate social responsibility.

Tax Credits & Tax Equity Investments

These opportunities include investing in federal or state-sponsored initiatives that offer tax credits or returns on the investment amount.

Includes investments in historic sites / buildings at the federal level, and affordable housing at a state level (e.g. Georgia)

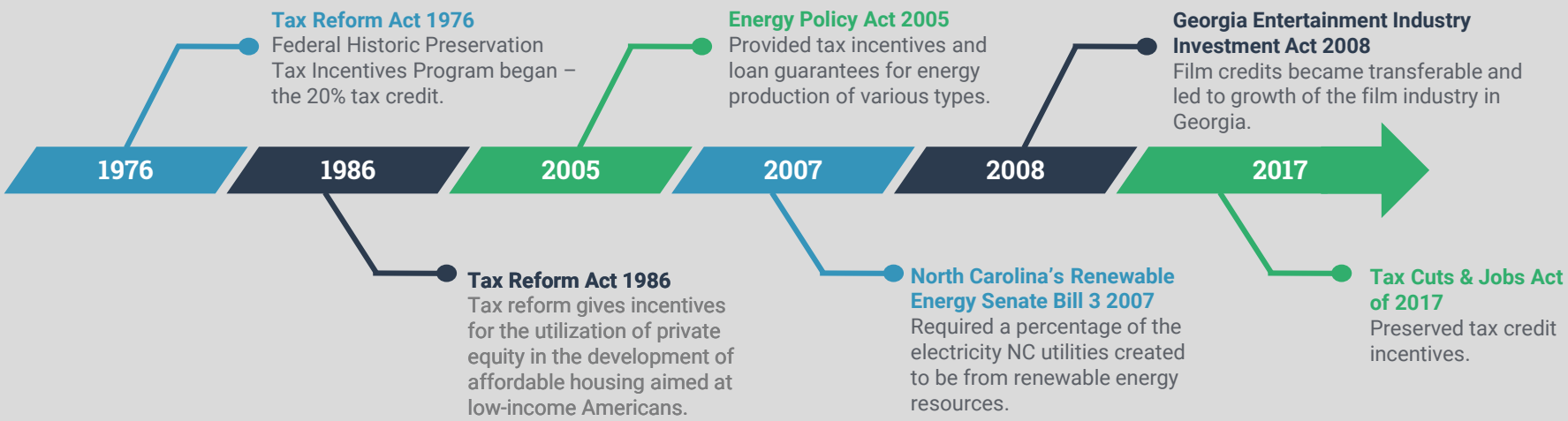
While these opportunities also foster positive public relations, they can be thought of more as an investment than a charitable donation.

History of Tax Credits & Tax Equity Investments

History & Key Developments

While many government tax credit and equity investment programs were created under the 1986 Tax Reform Act, there have been an array of legislative and regulatory developments over the past several decades that have broad implications for investors.

The IRS also continues to monitor these programs and release new guidelines and associated legislation; as such, it is pivotal that treasury, accounting, and legal teams stay abreast of the industry as new developments are brought forth.



Layers of Benefits

Additional Investment Benefits: SRI

- Environmental Benefits leading to the reduction of one's carbon footprint
- REC's or Renewable Energy Certificates may be obtained for a fee through a tax equity investment
- 1 REC equals 1 Megawatt per hour of solar energy generation
- By owning/purchasing REC's you are contributing to the State's policy toward meeting it's Renewable Portfolio Standards
- Leading to favorable PR and alignment with many "CSR" programs and other programs such as "SRI" Socially Responsible Investing

Financial Distinctions

Tax Credits vs. Tax Deductions

Tax credits are government incentives used to encourage investment or funding of certain projects by mitigating the tax liabilities for businesses that participate.

A tax credit is more valuable than a deduction because it allows the taxpayer to reduce their tax liability dollar-for-dollar, rather than reducing their taxable income (see chart on right).

There are a number of different tax credit programs that exist through both federal and state-sponsored initiatives.

In Georgia, the most prominent example of a tax credit program is the state's film tax credit, which has helped boost state revenue from the film industry from $241 million in 2007 to $9.5 billion in 2017.

	Tax Deduction	**Tax Credit**
Income	$500,000	**$500,000**
Charitable Contribution	($100,000)	**---**
Taxable Income	$400,000	**$500,000**
Tax Rate	21%	**21%**
Tax Credit	---	**$100,000**
Taxes Due	$84,000	**$5,000**
Tax Savings	$21,000	**$100,000**

Program Types

Distribution of Tax Credit & Equity Investment Programs

Federal Projects

Low-Income Housing Tax Credit (LIHTC)
The federal government's primary program for encouraging private investment in the development of affordable rental housing for low-income households.

Historic Tax Credits (HTC)
Encourages private sector investment in the rehabilitation of historic buildings.

Renewable Energy Investment Tax Credit
Encourages the construction of renewable energy production facilities, including solar energy.

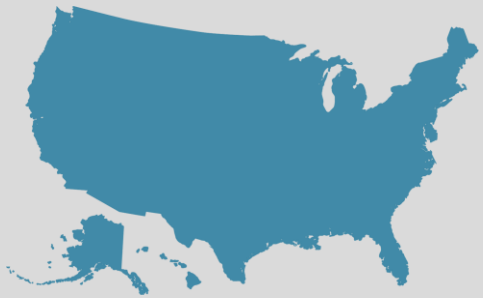
State Projects

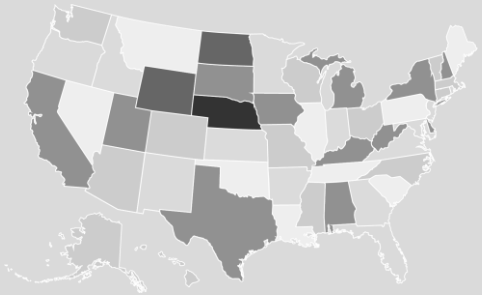
Film, Television, & Digital Entertainment
The film and entertainment business generates an influx of jobs and purchases in a filming location. The economy is also boosted by the production crews' and actors' use and sponsorship of local business.

Affordable Housing Tax Credit
Awarded for private investment in the development of affordable rental housing for low-income households.

Historic Tax Credit (HTC)
Awarded for private investment in the rehabilitation of historic buildings. Some states offer Abandoned Mill and/or Textile Revitalization credits as well.

Market Snapshot





	Federal Projects	State Projects
Market Size (Tax Credits Issued Annually[1])	$12.3 Billion	$4.7 Billion
Projected Market Growth	20%	Various (Based on State Legislation)
Recent Developments	Conversion of Historic Tax Credits from a 1-year to 5-year credit.	Indiana's industrial revolution credits ("DINO") are generating significant economic activity in that state.

1. Annual estimates for federal and state tax credits issued across Economic/Regional Development, Renewable Energy, Film, Historic Rehabilitation, and AHTC tax credit programs

Federal Tax Credit Programs

Solar Energy

- Creates immediate GAAP permanent income.
- ITC is a one year credit that can be carried back one year and forward 20.
- IRR and net benefit is significant (receive substantial ITC and depreciation benefits).
  8-14% After-tax ROI.
- Very low risk underlying economics.
- Five year step recapture.
- No known recapture in industry.

Low Income Housing

- Requires purchase of a multi-year strip.
- Guidance exists which eliminates GAAP concerns.
- Credits yield tax losses due to depreciation and usually no cash flow distributions.
- Fifteen year recapture period & extremely low recapture experience in industry.
- Returns are single digits due to CRA competition.

Historic Rehabilitation

- Usually bought at a discount to the credit.
- Minimal depreciation and cash flow.
- Structured consistent with IRS Revenue Procedure §47.
- Returns typically in the low teens.
- Five year step recapture.
- Extremely low recapture risk in industry.

Intro to Tax Credits & Tax Equity Investments

Tax Credit Classification

Two common types of credits are investment credits and production credits

- **Investment Credits** typically provide a credit equal to a specified portion of eligible investment.
- **Production Credits** typically are earned over time based on the production of renewable energy that is generated from the company's investment.

At the state level, there are often investment credits as well as exemptions / abatements and renewable energy certificates (RECs).

Depending on the investment structure utilized, there may be other tax preference items available, such as accelerated depreciation.

Tax Credit Structures

Each tax credit structure has particular technical requirements that must be satisfied.

- **Partnership Flip** is the most typical transaction structure.

While there are IRS safe harbors that provide reassurance for some types of investments, these are limited and do not always reflect commercial realities.

Investors also need to consider their specific tax position, tax capacity, and unique tax legislative environment.

How it Works: Common Structure & Participants

Pre-Flip Period

- Developer receives 1% of cash distributions* and tax allocations
- Investor receives 99% of cash distributions* and tax allocations

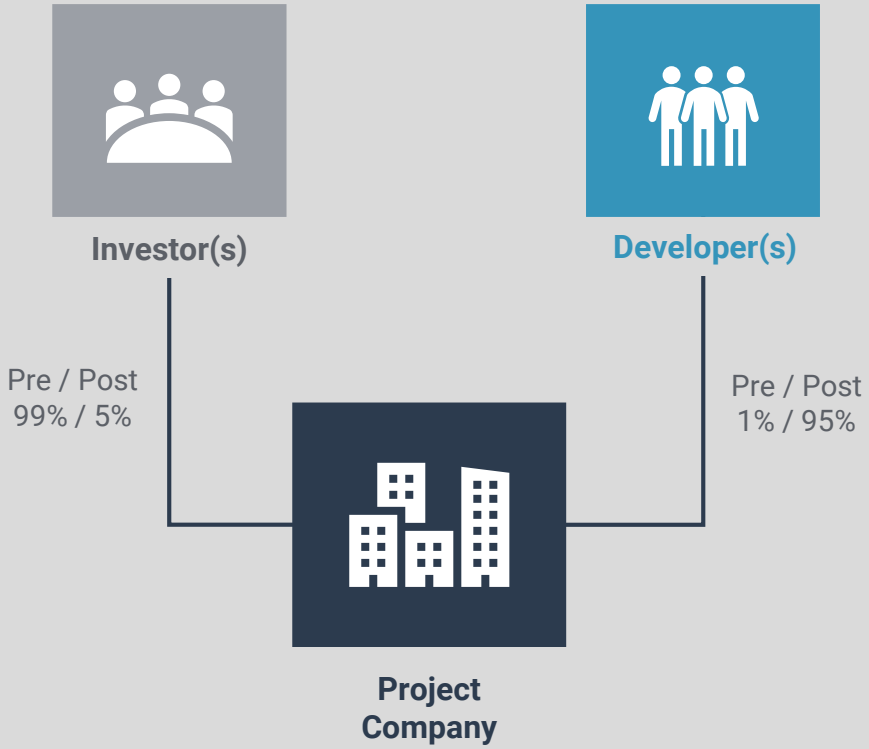
Post-Flip Period

- Developer receives 95% of cash distributions and tax allocations
- Investor receives 5% of cash distributions and tax allocations

Flip occurs when Investor achieves specified after-tax IRR

Developer may have option to purchase Investor's interest post-flip at then fair market value.

Partnership Flip Structure



Perspectives on Common Structure

Partnership Flip Structure

Advantages

- Widely used and accepted structure
- Established IRS guidance regarding structure in context of wind projects (Rev. Proc. 2007-65) and rehab credit projects (Rev. Proc. 2014-12)
- Developer's repurchase option is less costly because Investor's residual interest is only 5%
- Available for production tax credit (PTC) or investment tax credit (ITC)

Disadvantages

- In case of ITC, Investor must be in partnership before placed-in-service date
- Complex partnership tax rules and financial accounting

Tax Credit Initiatives: Top Challenges

Placed-in-Service

- The point in time when property (long-term asset) can be depreciated or granted a tax credit. The date the asset is "placed in service" marks the beginning of the depreciation period (Investopedia).
- Regulations and case law have placed strict guidelines on how and when a company (investor) can list their investment or project as being placed-in-service.

Structure Issues

- Courts can disallow tax benefits otherwise allowable under the technical rules of the code when the transaction does not have economic substance, lacks a business purpose, or when the substance of the transaction is not consistent with its form.
- Tax equity investors need to ensure that the economic arrangements of their investment are consistent with the chosen structure for the transaction.

Valuation Issues

- For passthrough lease transactions, the amount of the ITC is determined by reference to the FMV of the "energy property" at the time the project is leased.
- For grant programs, U.S. Treasury has closely scrutinized grant applications claiming a basis that exceeds certain benchmarks.
- Many pending cases in litigation involve valuation issues in the context of projects for which grants were claimed.

Recapture

- Tax credits can be subject to recapture if the eligible property is sold or disposed of, or otherwise ceases to qualify as eligible property during the first five years following the placed-in-service date.
- Recapture occurs if any interest in any pass-thru entity that directly or indirectly has a stake in the eligible property is disposed of within the recapture period.

Tax Equity Investment: Case Study

The Company

- This particular case study is with regards to a Energy ITC Fund (i.e. a pool of investors as opposed to a single investor). However, the cash flows represented are indicative of a single investor, as opposed to the cash flows for the entire group at large.

The Situation

- 5-Year Investment in a 2018 Energy ITC Fund with a pool of investors, as opposed to a single investor. This particular fund in scope is managed by Monarch Private Capital; however, there are other funds of this type available on the market.

Project Parameters

- Partnership Flip Structure with NR Debt
- Project assumes 21% annual tax rate
- There is a call provision implemented at the 5th year

Tax Equity Investment: Case Study, Cont'd

Net Present value at a 10% Discount Rate	$6,092,799

Investor Equity Price Per $1 of Federal ITC	$ 1.1900

YEAR	2018	2019	2020	2021	2022	2023	2024	TOTALS (USD)
Federal Tax Rate	21%	21%	21%	21%	21%	21%	21%	
Federal Tax Credit Equity	(59,500,000)	-	-	-	-	-	-	(59,500,000)
Total Tax Savings (Expense)	14,403,911	(703,475)	(799,454)	(822,043)	(844,442)	(928,781)	-	10,305,716
Federal Investment Credit	50,000,000	-	-	-	-	-	-	50,000,000
Operating Cash Flow	643,600	1,337,500	1,337,500	1,337,500	1,337,500	1,395,834	-	7,389,434
Tax Benefit (Expense) from Call	-	-	-	-	-	-	(5,242,003)	(5,242,003)
Cash from Call	-	-	-	-	-	-	2,997,647	2,997,647
Annual Benefit from Fund	65,047,511	634,025	538,046	515,457	493,058	467,053	-	67,695,150
Annual Net Benefit From Fund	5,547,511	634,025	538,046	515,457	493,058	467,053	(2,244,356)	5,950,794
Cumulative Net Investment thru Call	5,547,511	6,181,536	6,719,582	7,235,039	7,728,098	8,195,150	5,950,794	-
Cumulative Benefit as a %	109.324%	110.389%	111.293%	112.160%	112.988%	113.773%	110.001%	

Final Thoughts

1. **Internal Teamwork: Collaboration is Key**
   While it might be treasury that spearheads participation in a tax optimization initiative, many of the actual documentation and reporting tasks will fall to the tax department and to accounting. As such, careful communication between the departments is crucial to ensuring a smooth and compliant process.

2. **Stay Abreast of the Market**
   Not only should businesses keep track of new tax policies and rulings, but should also keep in mind that the IRS is wary of businesses seeking to "ride the system" or generate excessive profits and are constantly altering the landscape to try and limit these scenarios.

3. **Available Projects & Investment Structures Vary by Region**
   Depending on your specific location, state and federal opportunities may vary widely. As such, businesses interested in these programs need to consider their specific circumstances and legislation; there is no "one-size-fits-all" approach. Liaise with tax advisors to ensure you are taking advantage of every program that's available to you.

4. **Benefits Exist on Multiple Fronts**
   Tax Equity Investments are socially responsible investments resulting in increased cash flow and higher earnings. They can be used both to improve corporate cash positions as well as positively impact the greater community and environment.

Contact Details & Additional Information

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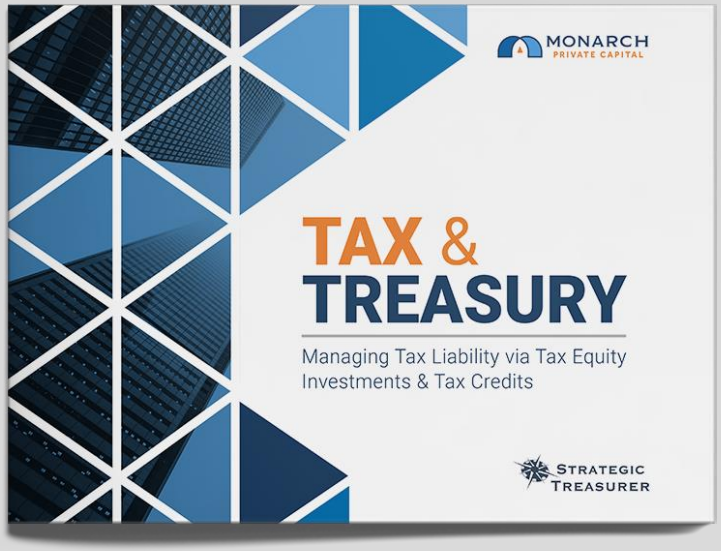

For more information regarding tax equity investments and tax credits and how to take advantage of such opportunities, click on the above image to download our free e-book.

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