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Community Development Finance & Affordable Housing Alert

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Low-income housing and community development tax credits in the Big Beautiful Bill

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Explore how the One Big Beautiful Bill Act boosts affordable housing with permanent LIHTC enhancements, bonus depreciation, and extension of the New Markets Tax Credit program.

What's the impact?

- Each state's allocation of 9% LIHTC is increased permanently by 12%.
- The private activity bonds (PABs) needed to obtain 4% credits is permanently reduced from 50% to 25% of aggregate basis.
- 100% Bonus Depreciation returns for items with a less than 20-year life, including furniture, fixtures, and equipment (FF&E) and landscaping.
- Energy and energy efficiency incentives have accelerated sunsets.
- New Markets Tax Credit program receives permanent extension.

On July 4, 2025, President Trump signed HR1, often referred to as the One Big Beautiful Bill Act (OBBBA), into law. The OBBBA was passed through Congress' reconciliation process. Overall impacts of the OBBBA vary by industry, but the direct impacts on low-income housing and community development finance are largely expected to be positive.

Low-Income Housing Tax Credit (LIHTC)

The Low-Income Housing Tax Credit (LIHTC) is a dollar-for-dollar tax benefit that is claimed over 10 years. The 9% credit provides just what the name promises—a credit equal to 9% of eligible basis in each of those 10 years. Similarly, the 4% credit provides an annual credit of 4% of eligible basis for 10 years. In simplified terms, eligible basis refers to the taxpayer's basis in depreciable property (which does not include land costs). A limited amount of 9% credits is available each year based on allocations to each state through a formula set by the Internal Revenue Service. As an alternative, the 4% credits are available when a specified percentage of a project's aggregate basis is financed with tax-exempt private activity bonds that have an allocation of volume cap (PAB).

Permanent increase in 9% credit allocation

Every state has a per capita allocation of housing credits, with a minimum amount for states with smaller populations. The allocation is adjusted annually for inflation, and the IRS announces each state's allocation annually. The 2017 Tax Cuts and Jobs Act included a temporary 12.5% increase in each state's allocation of 9% credits for calendar years 2018–2021. The OBBBA permanently increases each state's allocation by 12%. This increase will allow more projects to receive 9% credits through the competitive allocation process for each state.

Reduction of PABs required for 4% credit

Projects can qualify for 4% tax credits based on the proportion of qualified basis that is financed by PABs. Under prior law, a project could qualify for 4% credits for all of its qualified basis (without regard to the proportion financed by PABs) if 50% or more of the aggregate basis of the building and land was financed with PABs. Note that while the credit is calculated based solely on the eligible basis of the project, passing the 50% test is based on the percentage of the project's aggregate basis (including eligible basis and basis in land). The OBBBA lowers the 50% requirement to 25% if at least 5% of the aggregate basis is financed by PABs issued after December 31, 2025. The use of the term "issue date of which is after December 31, 2025" in the OBBBA indicates that the PABs financing at least 5% of aggregate basis for the project must be newly issued after 2025—simply drawing down undisbursed portions of 2025 PABs in 2026 will likely not meet the requirement.

An illustration may be helpful here. Assume an $8 million (land and building) project. Under prior law, that project required at least $4 million of PABs to qualify for 4% credits for all of its qualified basis. Under the OBBBA, a project placed in service in 2026 or later with total PABs of just $2 million, provided that PABs equal to at least 5% of $8 million ($400,000) are issued in 2026 or later, will qualify for 4% credits for all of its basis. Remember that because of the risk of cost overruns, and the amount of bonds to be issued in 2026 that both the 5% and 25% thresholds must be met to qualify for the 4% credits.

It should be noted that the OBBBA has been written to treat a 2025 (or earlier) acquisition coupled with a 2026 or later rehabilitation to both qualify for the 25% test.

As with 9% credits, the amount of PABs available in each state is limited annually by federal allocation. By reducing the amount of PABs required to qualify a project for 4% credits on the total eligible basis for the project, this change in statute will allow states to boost the number of projects being supported with 4% credits while maintaining current levels of their PABs issuance for low-income housing. Nixon Peabody practitioners will be engaged in discussions around the use of this additional authority.

While we note that the change from 50% to 25% of aggregate basis increases the amount of 4% LIHTCs available to projects, that does not necessarily decrease the debt needs for a particular project. Any increase in non-PAB debt financing may result in higher interest rate costs. This may lead to a rise in the use of so-called "recycling bonds" (i.e., PAB that financed another project which have now been prepaid.) Such bonds are no longer eligible to meet the 25% test, but they can be a source of gap financing that bears a tax-exempt interest rate.

100% bonus depreciation returns for FF&E

Generally, taxpayers can recognize cost recovery for certain expenses over a number of years through tax deductions. Historically, these deductions occurred on a level basis over the expected useful life of the property. Bonus depreciation through the modified accelerated cost recovery system (MACRS) allows this cost recovery to occur over an accelerated time horizon.

The 2017 TCJA allowed taxpayers to deduct the entire cost of qualified property (i.e., fixtures, furniture, equipment, and most other tangible depreciable property with a recovery period of 20 years or less) placed in service in 2017–2022, 80% if placed in service in 2023, 60% if placed in service in 2024, 40% if placed in service in 2025.

The OBBBA allows taxpayers to deduct the entire cost of qualified property in the year it is placed in service if the property is acquired after January 19, 2025. For these purposes, the OBBBA provides that acquisition is no earlier than the date on which a written binding contract is entered into for the acquisition. We note that there are no retroactive changes to bonus depreciation for the 2023 and 2024 tax years.

Remember that bonus depreciation is the default depreciation method. Because of capital account issues, many projects actually benefit from slower depreciation, and the OBBBA leaves in place the ability to elect out of bonus, as well as the ability to elect the prior 40% bonus depreciation rate for 2025.

Energy and efficiency

The OBBBA rolls back or sunsets many renewable energy and energy efficiency incentives that were enacted under the Inflation Reduction Act.

Among those changes is the elimination of the Section 45L new energy efficient home credit for property acquired after June 30, 2026. In Notice 2023-65, the IRS wrote "[t]he term 'acquired' includes purchased. The IRS also will consider a qualified home that is leased by a person from an eligible contractor for use as a residence during the taxable year as 'acquired' for purposes of § 45L(a)(1)(B)." For residential rental projects, this means that placement in service and leasing of the unit must occur by June 30, 2026. It will be important for parties to closely track their activities to determine eligibility for the 45L credit.

The OBBBA also accelerates the sunset of renewable energy tax credits for solar by eliminating the credit for projects that do not begin construction prior to July 4, 2026, or are placed in service after December 31, 2027. For this purpose, the word "project" refers to just the renewable project (e.g., solar on the roof of a residential facility) and not the overall housing project. The traditional tests for establishing that construction of a renewable energy project has begun remain intact for now (i.e., the "5% safe harbor" and the "significant physical work test;"); you can read more about them here. However, President Trump has directed the US Treasury to issue new standards to establish that a project has begun construction, and the effective date of any changes remains to be seen. Finally, new limits on the use of equipment from "foreign entities of concern" (FEOC) apply to projects which begin construction after 2025.

New markets tax credits permanency

The New Markets Tax Credit (NMTC) program provides a source of favorable financing for commercial projects in low-income communities. With growing frequency, low-income housing is being paired with wraparound services such as healthcare. For the most part, expenditures may be eligible under the NMTC program or the LIHTC program, but not both. We also see some projects that consist of two condos, one commercial benefiting from NMTCs and one residential, benefiting from LIHTCs. Prior to the OBBBA, the NMTC program was a temporary program scheduled to expire at the end of 2025. The OBBBA permanently extends the NMTC program at a $5 billion annual funding level.

New opportunities for developers

The OBBBA ushers in significant changes for low-income housing and community development, from increased LIHTC allocations and reduced PAB requirements to the return of 100% bonus depreciation and a permanent extension of the NMTC program. The OBBBA also extends a modified Qualified Opportunity Zone program. These adjustments create new opportunities for developers, investors, and community organizations. Nixon Peabody's community development finance and affordable housing lawyers are ready to help clients navigate these changes, maximize available benefits, and structure projects for long-term success in this evolving landscape.

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