Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Lowenthal | Analyst: Angela Raygoza | Bill Number: SB 585

Related Bills: See Prior Analysis | Telephone: 845-7814 | Amended Date: July 14, 2008

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Low-Income Housing Tax Credit Allocation

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ____________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ____________.

__X__ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED May 1, 2008, STILL APPLIES.

____ OTHER – See comments below.

SUMMARY

This bill would specify how the Low-Income Housing Credit (LIHC) may be allocated to partners and when losses of partners are recognized upon disposition.

SUMMARY OF AMENDMENTS

The July 14, 2008, amendments would do the following:

- Allocate credits to projects that receive a preliminary reservation of the state low-income housing tax credit on or after January 1, 2009, and before January 1, 2016.
- Provide that the partnership allocation rules, as specified, apply to any project that receives a preliminary reservation of credit on or after January 1, 2009, and before January 1, 2016.
- Add double-jointing language to incorporate provisions from SB 1247 (Lowenthal) that would streamline the LIHC and the Farmworkers Housing Credit (FWHC).

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Patrice Gau-Johnson	7/31/08
____ N	____ OUA	__X__ PENDING		

As a result of the July 14, 2008, amendments, the “This Bill,” “Effective/Operative Date,” “Economic Impact,” and “Technical Concern” discussions, as provided in the department’s analysis of the bill as amended May 1, 2008, have been revised. Except for the discussion in this analysis, the remainder of the department's analysis of the bill as amended on May 1, 2008, still applies. The policy concern remains and has been included below for convenience.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would take effect immediately and be specifically operative for projects that receive a preliminary reservation of the state low-income housing tax credit on or after January 1, 2009, and before January 1, 2016.

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would require a project that receives a preliminary reservation of the state low income housing tax credit on or after January 1, 2009, and before January 1, 2016, to be allocated to the partners of a partnership owning a low-income housing project, in accordance with a partnership agreement, regardless of how the federal LIHC is allocated to the partners or whether the allocation of the credit under the terms of the agreement has substantial economic effect[1].

This bill would require a deferral of any loss or deduction attributable to the sale, transfer, exchange, abandonment, or any other disposition of a partnership interest where the credit was allocated without substantial economic effect. The loss would be deferred until the first taxable year immediately following the end of the ten-year credit period that the federal credit is allowed.

The bill would make the provision to defer losses or deductions attributable to the sale or disposition of a partnership interest inoperative on or after January 1, 2016.

This bill also contains double-jointing language that would incorporate provisions from SB 1247 that would consolidate the FWHC into the state LIHC.

[1] Internal Revenue Code section 704(b) defines partner’s distributive share with respect to substantial economic effect.

TECHNICAL CONSIDERATIONS

As a result of the double-jointing language, a technical concern has been identified relating to the deferral of partner losses. Because the state FWHC does not always receive a federal LIHC for a farm worker housing project, losses related to the disposition or abandonment of a partnership interest could be deducted in the first year after claiming the credit, instead of one year after the federal LIHC expires. See the Revenue Estimate below for impact. Department staff are available to assist the author in resolving this concern.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact from this bill would be as follows:

Revenue Analysis for SB 585 – As amended on 7/14/08 Operative January 1, 2009			
Fiscal Year	2008-2009	2009-2010	2010-2011
Low Income Housing*	$0	$0	$0
Farmworker Housing	$0	$0	< -$150,000

*Beginning in fiscal year 2012-2013, the LIHC provisions of this bill would result in an estimated revenue loss of $0.7 million. Losses increase each year thereafter. When fully phased in (2015-16 fiscal year), the potential annual revenue losses would be $1.2 million from accelerated credit usage. Starting with fiscal year 2023-2024, ten years following the first tax year of the federal credit period, there will be an estimated revenue loss of $0.2 million from capital losses on abandonment.

This analysis does not consider any possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

This bill allows for a federal-state LIHC to be divided on a prospective basis for preliminary credit reservations first made after January 1, 2009. Due to the estimated three-to four-year delay from the date of preliminary reservation to the date final allocation is given, the revenue impact from accelerated credit usage would not occur until the 2012 tax year. The revenue impact would occur outside the budget window. This analysis assumes that 4% of credits allocated are unapplied after the four-year credit period. In 2012, it is estimated that 25% of the unused credit would be applied resulting in approximately $700,000 of accelerated revenue losses.

This bill allows a low-income housing partnership to share the state LIHC to partners without economic interest. If a partner or member who purchases the divided state LIHC has no other connection to the partnership after allocated credits are applied, the act of abandoning their interest results in an added tax benefit. The benefit occurs as a deductible capital loss on abandonment that is equal to the purchase price of the partnership/LLC share that was created for the sole purpose of distributing the LIHC. This analysis assumes no more than 10% of future credit allocations would result in a capital loss on abandonment in any given year beginning with tax year 2023 (three-year lag plus 10-year federal credit allocation period plus one year after credit period expires = 2009 plus 14 years).

For the first year there is an impact from the abandonment loss (2023), it is assumed that the bill would result in capital losses equal to 2.5 percent of the credits generated that year. Based on a projected $103 million in state LIHC generated in 2022, the amount of capital losses generated in the 2023-2024 fiscal year would be approximately $2.6 million ($103 million X 2.5%). Because most partners are corporations, the $2.6 million is multiplied by an 8.84 percent tax rate to arrive at a state revenue loss of approximately $0.2 million. It is assumed that in later years the amount of capital losses generated from abandonment would equal 10 percent of state LIHC credits generated, equal to around $1 million in total in the 2025-2026 fiscal year.

The July 14, 2008, amendments clarify that the division of credits applies only to projects that receive a preliminary reservation of the LIHC on or after January 1, 2009. The revenue change from this amendment is insignificant.

Revenue Effects from Double-Jointing

Unlike the LIHC, the FWHC can be allocated without receiving any federal LIHC. The double-jointing language could allow a FWHC that does not have a corresponding federal LIHC to be allocated to partners lacking substantial economic effect, thereby creating abandonment losses without a ten-year “waiting period.”

Historically, less than $10,000 in FWHC has been claimed in any given year. Assuming that these amendments result in $15,000 in additional FWHC being issued each year, there would be additional annual losses of less than $15,000 applied against tax beginning in fiscal year 2010-2011.

Additionally, there would be abandonment losses resulting from the FWHC that do not have a corresponding federal credit. The value of these losses is equal to the marginal tax rate times the total amount of abandonment losses claimed. Assuming that the total FWHC is less than $50,000 and that 60% of these credits do not have a corresponding federal credit, then there would be an additional revenue loss of $2,700 ($50,000 x .60 x .09) beginning in 2011-2012. These estimates of abandonment losses are based on approximations of the total FWHC, the percent that have federal credits, and the marginal income tax rate. The revenue loss from abandonment losses is expected to be insignificant.

POLICY CONCERN

This bill would disconnect ownership of the property from eligibility for the credit, thus severing the credit from a taxpayer's economic interest in the profits and losses of the project. Because the Committee could issue this credit to any partnership, corporation, or business entity, this action could lead to allocations for tax shelter purposes. For example, investors would be able to "buy" rights to low-income housing credits through the purchase of a partnership share. When all of the credits, which could exceed the cost of investment, have been utilized, the investor could walk away from the partnership with a partnership loss to apply against other partnership income.

As a result, the investor would benefit twice from the arrangement: first by use of the credit and second by the partnership loss.

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