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:	August 8, 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 ________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED July 14, 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 August 8, 2008, amendments clarify that the special partnership allocation rules and deferral of abandonment losses do not apply to state low-income housing tax credits set aside for Farmworker Housing Credits (FWHC) unless the FWHC project also receives a preliminary reservation of federal low-income housing tax credits.

As a result of the August 8, 2008, amendments the "This Bill," "Economic Impact," and "Technical Concern" discussions, as provided in the department's analysis of the bill as amended July 14, 2008, have been revised. The amendments also resolve the technical concern addressed in the July 14, 2008, analysis. Except for the discussion in this analysis, the remainder of the department's analysis of the bill as amended on July 14, 2008, still applies. The policy concern remains and has been included below for convenience.

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	8/18/08
____ N	____ OUA	__X__ PENDING	for Patrice Gau-Johnson	

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.

To prevent chaptering issues, this bill contains double-jointing language that would incorporate provisions from SB 1247 that would consolidate the FWHC into the state LIHC. This bill would clarify that the special partnership allocation rules and deferral of abandonment losses does not apply to state low-income housing tax credits set aside for FWHCs unless the FWHC project also receives a preliminary reservation of federal low-income housing tax credits.

TECHNICAL CONSIDERATIONS

Amendments 1-3 are provided to correct cross-reference errors.

ECONOMIC IMPACT

The revenue impact from this bill would be as follows:

Revenue Analysis for SB 585 – As amended on August 8, 2008 Operative January 1, 2009			
Fiscal Year	2008-09	2009-10	2010-11
Low Income Housing*	$0	$0	$0

*Beginning in fiscal year 2012-13, 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 2023-24, 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.

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

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. This analysis assumes that 4% of credits allocated are unapplied after the four-year credit period. In 2012, it is estimated that 25% of $2.8 million in unapplied LIHC would be accelerated resulting in $700,000 ($2.8 million unapplied LIHC X 0.25 = $700,000 revenue loss) of revenue losses. The revenue impact would occur outside the budget window.

This bill allows a low-income housing partnership to distribute the state LIHC to partners without economic interest in the housing project. 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 that 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 (2023) there is an impact from the abandonment loss, it is assumed that the bill would result in capital losses equal to 2.5% 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 2023-24 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% 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% of state LIHC credits generated, equal to approximately $1 million in total revenue losses ($108 million X .10 assumed abandonment losses X .0884 tax rate = $1 million revenue losses) in the 2025-26 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
The double-jointing amendments do not directly impact the revenue estimate for SB 585. However, if both this bill and SB 1247 pass, there will be an estimated revenue impact from abandonment losses attributed to FWHCs of less than $150,000 beginning in fiscal year 2021-22 from the FWHC provisions in SB 1247.

For partnerships that work on FWHC project and receive a federal credit, the value of any future revenue 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 40% of these credits have a corresponding federal credit there would be an insignificant revenue loss of $1,800 ($50,000 x .40 receive federal credit x .09 marginal tax rate) beginning in fiscal year 2021-22. These estimates of abandonment losses are based on estimates of the total FWHC, the percent that have federal credits, and the marginal tax rate.

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 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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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 585
As Amended August 8, 2008

AMENDMENT 1

On page 12, line 35, after "Section 50199.20" insert:

of the Health and Safety code

AMENDMENT 2

On page 31, line 32, after "Section 50199.20" insert:

of the Health and Safety code

AMENDMENT 3

On page 53, line 9, after "Section 50199.20" insert:

of the Health and Safety code