Franchise Tax Board **REVISED ANALYSIS**

Author:	Lowenthal	Analyst:	Angela Raygoza	Bill Number:	SB 713
Related Bills:	See Legislative History	Telephone:	845-7814	Original Analysis Date:	April 9, 2007
		Attorney:	Douglas Powers	Sponsor:	

SUBJECT: Farmworker Housing Credit/Partner's Distributive Share Of Credit Is Determined By Partnership Agreement

__X__ REVENUE ESTIMATE CHANGED.

_____ FURTHER CONCERNS IDENTIFIED.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 9, 2007, STILL APPLIES.

_____ OTHER – See comments below.

SUMMARY OF BILL

This bill would consolidate the farmworker housing tax credit (FHTC) program into the state low-income housing tax credit (LIHC) program, and make changes to how the state LIHC may be allocated to partners.

SUMMARY OF REVISION

The "Economic Impact" discussion in the department's analysis of the bill as amended April 9, 2007, is being revised to reflect additional data available for estimating the revenue impact for the LIHC provision of the bill.

Except for this change, the remainder of the department's analysis of the bill as amended April 9, 2007, still applies.

POSITION

Pending.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Brian Putler	5/24/07
_____ N	_____ OUA	__X__ PENDING		

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the personal income tax and corporation income/franchise tax revenue impact from this bill would be as follows:

Revised Revenue Analysis for SB 713 – as amended 4/09/07 Effective and Operative January 1, 2008 Enactment assumed after June 30, 2007			
Fiscal Year	2007-08	2008-09	2009-2010
FHTC	Loss < $250,000	Loss < $250,000	Loss < $250,000
LIHC	-$500,000	-$3 Million	-$4 Million

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

Revenue Discussion

The original revenue estimate of the bill as amended April 9, 2007, obtained the amount of low-income housing tax credits allocated by the California Tax Credit Allocation Committee's (TCAC) from the TCAC's 2005 annual report. The amounts included in the TCAC's 2005 annual report were estimated amounts of tax credits allocated. Subsequent to the original revenue estimate, the TCAC provided the department with actual forms[1] that provided the actual, instead of estimated, amounts of low-income housing tax credits allocated. Upon review of this new information, the original estimate of the LIHC provision of the bill as amended on April 9, 2007 is being revised. The original analysis of the FHTC provision of this bill and associated estimated revenue impact remains unchanged but is repeated for convenience.

This bill would consolidate the FHTC program into the state LIHC program. In addition, this bill would require partnerships to allocate each partner's distributive share of the LIHC based on the partnership agreement, without regard to the "substantial economic effect" rules of Section 704(b) of the Internal Revenue Code.

FHTC

A historical review of the FHTC claimed showed that a very small number of taxpayers actually claim the credit, less than ten per year. Assuming that this bill would have some positive incentive pertaining to a growth in farmworker housing, the additional revenue loss would be insignificant.

[1] Form 3521-A: Certificate of Final Award of California Low-Income Housing Tax Credit.

Because the FHTC would be allocated in the same manner as the LIHC, the California Tax Credit Allocation Committee (TCAC) could issue the FHTC to any partnership, corporation, or business entity, resulting in immediate use of tax credits by transferees, sellers, and assignors. For example, investors would be able to "buy" rights to the FHTC through the purchase of a partnership interest. The revenue effects could include both cash-flow acceleration of tax credit usage and absolute revenue losses. Absolute revenue losses would occur assuming some transferors, sellers, or assignors would have been unable to ever utilize all the potential tax benefits generated.

<u>LIHC</u>

This analysis assumes that this bill would cause accelerated usage of final credits allocated but unapplied against income tax liabilities within the four-year state credit period. Based on a revised method of comparing LIHC historical data from the TCAC against internal data on amounts of LIHC allowed per tax return filed, on average, an estimated 4% of LIHCs are allocated, but remain unapplied against income or franchise taxes after the four-year state credit period. Unapplied credits for 2008 totaled approximately $3 million, of which some portion is likely to be transferred under proposed law. Assuming 50% of the credit that is available but unused in 2008 would be used under proposed law conditions, enacting this bill would increase credit usage by an estimated $1.5 million starting in 2008 ($3 million x 50%). As awareness increases, this acceleration of credit usage is estimated to grow to about 80% in the later years.

Next, our analysis more closely examines the possible revenue impact occurring after credits are assigned, transferred, or sold. The bill would create a situation in which partnerships are allowed to structure their partnership agreements such that some partners could own shares of the state LIHC that are disproportionate to their economic interest in the project. In the cases in which the state LIHC is bifurcated from the other aspects of the partnership, the partner who purchases the LIHC portion of the partnership would have an incentive to walk away from the partnership after they had used their state LIHC. When that partnership interest is abandoned, a capital loss equal to the purchase price of the partnership share would be generated for state income and franchise tax purposes. For the first impact year of this estimate (2008), it is assumed that the bill would result in capital losses equal to 10% of the credits generated that year. Thus, based on a projected $80 million in state LIHC generated in 2008, the amount of capital losses generated in the 2008 tax year would be approximately $8 million ($80 million X 10%). Because most partners are corporations, the $8 million is multiplied by the 8.84% tax rate to arrive at a state revenue loss of $0.7 million. It is assumed that in later years, the amount of capital losses generated from abandonment would equal 40 % of state LIHCs generated.

For the 2008 calendar year, the total revenue loss associated with the LIHC provision of this bill is estimated at just over $2 million (about $1.5 million for additional credit usage and about $0.7 million for capital losses). The fiscal year estimate for 2007/08 includes $0.5 million of this $ 2 million. The estimate for the 2008/09 fiscal year includes about $1.5 million from the 2008 tax year and about $1.5 million from the 2009 tax year, or a total of $3 million in fiscal revenue losses.

The revenue estimate from the analysis of the bill as amended on April 9, 2007, that is being replaced is provided below for convenience:

Replaced Revenue Analysis for SB 713 – as amended 4/09/07 Effective and Operative January 1, 2008 Enactment assumed after June 30, 2007 ($ in Millions)			
Fiscal Year	2007-08	2008-09	2009-2010
Farmworker Housing	Loss < $250K	Loss < $250K	Loss < $250K
Low-Income Housing	-$3	-$11	-$12

Replaced Revenue Discussion

This bill would consolidate the farmworker housing tax credit program into the state low-income housing tax credit program. In addition, this bill would require partnerships to allocate each partner's distributive share of the low income housing credit based on the partnership agreement.

A historical review of the farmworker housing tax credits claimed showed that a very small number of taxpayers actually claim the credit, less than ten per year. Assuming that this bill would have some positive incentive pertaining to a growth in farmworker housing, the additional revenue loss would be insignificant.

Because the farmworker housing credit would be allocated in the same manner as the low-income housing credit, the TCAC could issue the farmworker housing credit to any partnership, corporation, or business entity resulting in immediate use of tax credits by transferees, sellers, and assignors. For example, investors would be able to "buy" rights to farmworker housing credits through the purchase of a partnership share. The revenue effects could include both cash-flow acceleration of tax credit usage and absolute revenue losses. Absolute revenue losses would occur assuming some transferors, sellers, or assignors would have been unable to ever utilize all the potential tax benefits generated.

Based on data from the California Tax Allocation Committee's 2005 Annual Report and actual historical usage data, approximately $14 million in low-income housing tax credits are allocated but remain unapplied each year. Given the opportunities to sell unused credits, it is assumed that $12 million of any unused credits would be transferred ($14 million allocated low-income credit x 90% estimate unused credits = $12 million). Additionally, it is assumed that $10 million in transferred credits are applied in the year of transfer with unused amounts carried over and used in subsequent years. For 2008, the estimated amount of new credit usage is $10 million ($12 million unused credits x 80% estimate new credit usage = $10 million).

Amounts shown in the above table reflect fiscalized impacts.

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