Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Romero	Analyst:	David Scott	Bill Number:	SB 1316
Related Bills:	See Prior Analysis	Telephone:	845-6111	Amended Date:	June 28, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Low Income Community Investment Credit/Non-recognized Gain Does Not Include Out-Of-State Property Exchanges

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

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

X AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analyses of bill as amended April 22, and June 16, 2010.

X FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO __________________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AMENDED June 16, 2010, STILL APPLIES.

X OTHER – See comments below.

SUMMARY

This bill would do the following:

- *Provision 1:* This provision would provide a California New Markets Tax credit for investments in businesses that provide capital or loans to low-income communities.
- *Provision 2:* This provision would deny non-recognition treatment for like-kind exchanges, where gains and losses are deferred on the transaction, for exchanges of California real property for out-of-state real property.

SUMMARY OF AMENDMENTS

The June 28, 2010, amendments made the following changes to the bill:

- Revised the operative date for both provisions to taxable years beginning on or after January 1, 2011, and before January 1, 2012.
- Resolved the implementation consideration discussed in the department's analysis of the bill as amended June 16, 2010. (See Appendix A).

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Patrice Gau-Johnson	07/07/10
____ N	____ OUA	X PENDING		

Except for the "Effective/Operative Date," "This Provision," and "Economic Impact" discussions, the remainder of the department's analysis of the bill as amended June 16, 2010, still applies. The "Legal Impact" and "Arguments/Policy Concerns" discussions under Provision 1 and the "Arguments/Policy Concern" discussion under Provision 2 have been provided for convenience.

EFFECTIVE/OPERATIVE DATE

The provisions of this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2011, and before January 1, 2012.

POSITION

Pending.

ECONOMIC IMPACT – SUMMARY REVENUE TABLE

Estimated Revenue Impact of SB 1316 Amended June 28, 2010 For Tax Years Beginning On or After January 1, 2011 Assumed Enactment Date by September 30, 2010 ($ in Millions)			
	2010-11	2011-12	2012-13
Provision 1: Qualified Community Development Entities (QCDE) Credit used based on allocations of $2.6 million in 2010-11, $4.0 million in 2011-12, $0.6 million in 2012-13	($2.5)	($3.9)	($0.6)
Provision 2: Recognition Treatment for Only Non-California Property Like-Kind Exchanges	$2.5	$3.9	$0.6
Net Impact to General Fund	($0)	($0)	($0)
This bill requires credits to be awarded based on the FTB's estimates of revenue generated from denying like-kind exchange treatment for non-California property. To the extent that actual revenue generated differs from the estimate, the bill would result in net revenue gains or losses.			

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

Provision 1: California New Markets Tax Credit

ANALYSIS

THIS PROVISION

Under Personal Income Tax Law and Corporation Tax Law, this provision would allow to a taxpayer that holds a qualified equity investment (QEI) on a credit allowance date a tax credit equal to 39 percent of the QEI.

This provision provides various definitions including the following:

- QEI means any equity investment in a QCDE if all the following conditions are met:
    - The investment was acquired for cash at its original issue or subsequently.
    - Substantially all of the cash is used by the QCDE to make investments in low-income communities. This requirement is deemed met if at least 85 percent of the assets of the QCDE are invested in low-income community investments.
    - The investment is designated by the QCDE.
- Credit allowance date means the date on which the investment is initially made.
- Equity investment means any stock, other than nonqualified preferred stock, in a corporation, or any capital interest in a partnership.
- QCDE means a domestic corporation or partnership that meets all of the following conditions:
    - Has as its primary mission serving or providing investment capital for low-income communities or low-income persons located in California.
    - Maintains accountability to residents of low-income communities through representation on a governing board, an advisory board, or other similar community body.
    - Is certified by the Treasurer as being a QCDE.

The aggregate amount of credits for any calendar year would be capped at an amount equal to 100 percent of the aggregate revenue increase in the same calendar year as a result of the disallowance of like-kind exchange treatment, as specified in Provision 2 of this bill.

This provision provides additional rules that would do all of the following:

- Require the taxpayer to recapture credits previously utilized to reduce tax if the QCDE redeems the investment, the investment ceases to be used in the required manner, or the QCDE ceases to be a QCDE.
- Disqualify the business if the corporation repurchases its own stock.
- Allows for the transfer of a QEI.
- Allows the Treasurer to reallocate unused credits if not used within five years.

In addition, this provision does not provide for a carryover of unused credits by the taxpayer.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 1316, Provision 1 For Tax Years Beginning On or After January 1, 2011 Assumed Enactment Date by September 30, 2010 ($ in Millions)			
	2010-11	2011-12	2012-13
QCDE Credit used based on allocations of $2.6 million in 2010-11, $4.0 million in 2011-12, and $0.6 million in 2012-13	($2.5)	($3.9)	($0.6)

LEGAL IMPACT

Federal law prohibits discriminatory state taxation of interest on federal securities. This bill would allow a credit for investment in entities that make loans to entities engaged in a trade or business in low-income communities. This incentive, which provides an indirect subsidy to non-federal loans, could be considered to result in a violation of the federal law prohibiting discriminatory state taxation of interest on federal securities.

ARGUMENTS/POLICY CONCERNS

- This provision lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

- The provision's criteria that a corporation must be a domestic corporation (to be a QCDE) may present constitutional concerns by discriminating against foreign commerce if the term "domestic" means "U.S.", or by discriminating against interstate commerce if the term "domestic" means "California" (as would be the case if Corporations Code definition applies). This issue also arises under "S" corporation rules.

Provision 2: Elimination of Like-Kind Exchange Treatment for Outbound Exchanges

ANALYSIS

<u>THIS PROVISION</u>

This provision would exclude from like-kind exchange treatment (non-recognition of gains or losses until the asset is ultimately disposed of) for exchanges where non-California real property is received in exchange for California real property for taxable years beginning on or after January 1, 2011, and before January 1, 2012.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Estimated Revenue Impact of SB 1316 Provision 2 For Tax Years Beginning On or After January 1, 2011 Assumed Enactment Date By September 30, 2010 ($ in Millions)			
	2010-11	2011-12	2012-13
Recognition Treatment for Only Non-California Property Like-Kind Exchanges	$2.5	$3.9	$0.6

ARGUMENTS/POLICY CONCERN

This provision would disallow gain deferral treatment of an exchange of out-of-state real property for California real property. This provision is likely to be subject to a constitutional challenge and could be expected to be interpreted by the courts as unlawful discrimination against out-of-state taxpayers under the commerce clause of the U.S. Constitution.

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APPENDIX A

RESOLVED IMPLEMENTATION CONSIDERATION

Provision 1: California New Markets Tax Credit

Implementation Consideration Discussed In the Department's Analysis of the Bill as Amended June 16, 2010.

The provision requires that the FTB certify the aggregate revenue increase from the disallowance of the deferred gain treatment on like-kind exchanges for a calendar year. The provision also says that the credits for a calendar year will be based on the certified revenue increase for the same calendar year. The certification could not be done until at least 18 months after the credit allocation is to be supposed to be made because of the timing of taxpayers filing, time to process the return, and then analyze the information. As a result, the timing of the credit allocation and the revenue certification would not match as required in the bill. This concern would be eliminated if the FTB were allowed to estimate the revenue increase, rather than certify the revenue increase.