

**SUMMARY ANALYSIS OF AMENDED BILL**

Author: Romero Analyst: David Scott Bill Number: SB 1316  
 Related Bills: See Prior Analysis Telephone: 845-5806 Amended Date: August 2, 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 \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended June 28, 2010.  
 X

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED June 28, 2010, STILL APPLIES.  
 X

OTHER – See comments below.  
 X

**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 August 2, 2010, amendments would do the following:

- Require the California Tax Credit Allocation Committee (CTCAC) to administer the credit instead of the Treasurer's office.
- Clarify that 50 percent of total gross income of the entity and the use of tangible property must be from activity in California.

Board Position:	Asst. Legislative Director	Date
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- Revise the language of what is deemed to be a qualified community development entity.
- Allow CTCAC to adopt guidelines to administer the credit and charge a reasonable fee to defray the costs of administering the program.
- Clarify that a credit recapture event must occur before the end of the seventh year after the investment is made.
- Add an exception to the requirement that 85 percent of the gross assets be invested in a qualified low income community investment.
- Adds a repeal date to the disallowance of like-kind exchange treatment on out-of-state property received for in-state property.

Except for the “This Provision” discussion for Provision 1, the remainder of the department’s analysis of the bill as amended June 28, 2010, still applies. The “Legal Impact” and “Arguments/Policy Concerns” discussions under Provision 1 and the “Arguments/Policy Concern” discussions under Provision 2 remain and have been provided below for convenience. The “Economic Impact” of both provisions has been repeated below for convenience.

**ECONOMIC IMPACT**

Revenue Estimate

<b>Estimated Revenue Impact of SB 1316, As Amended June 28, 2010                      For Taxable Years Beginning On or After January 1, 2011                      Assumed Enactment Date by September 30, 2010                      (\$ in Millions)</b>			
	2010-11	2011-12	2012-13
<b>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</b>	(\$2.5)	(\$3.9)	(\$0.6)
<b>Provision 2: Recognition Treatment for Only Non-California Property Like-Kind Exchanges</b>	\$2.5	\$3.9	\$0.6
<b>Net Impact to General Fund</b>	(\$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 replacement 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.

## **POSITION**

Pending.

## **PROVISION 1 - 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 Qualified Community Development Entity (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 CTCAC as being a QCDE.
  - Has passed the federal new markets credit screening and has a federal new markets credit allocation agreement.

The CTCAC will impose a reasonable fee upon credit applicants, to offset the costs of administering the program. The CTCAC will adopt guidelines necessary to administer the program. The guidelines would not be subject to the rulemaking requirements of the Administrative Procedures Act.

An exception was added to the requirement that 85 percent of gross assets must be invested in a Qualified Low Income Community Investment for the duration of seven year credit period. The exception says the if the investment meets the 85 percent test, even if sold, for a six year period, they are deemed to meet the test for the seventh year. The CDE would not be required to reinvest any capital returned after the sixth year.

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.

#### **PROVISION 1 - 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

#### **PROVISION 1 - 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.
- The exception to the capital reinvestment requirement after the sixth year does not follow the capital investment requirements for the federal new markets credit.

**PROVISION 1 - ECONOMIC IMPACT**

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**PROVISION 2 - ARGUMENTS/POLICY CONCERNS**

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

**PROVISION 2 - ECONOMIC IMPACT**

Revenue Estimate

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### **LEGISLATIVE STAFF CONTACT**

Legislative Analyst

David Scott

(916) 845-5806

[david.scott@ftb.ca.gov](mailto:david.scott@ftb.ca.gov)

Revenue Manager

Monica Trefz

(916) 845-4002

[monica.trefz@ftb.ca.gov](mailto:monica.trefz@ftb.ca.gov)

Asst. Legislative Director

Patrice Gau-Johnson

(916) 845-5521

[patrice.gau-johnson@ftb.ca.gov](mailto:patrice.gau-johnson@ftb.ca.gov)