Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Lowenthal | Analyst: Angela Raygoza | Bill Number: SB 16

Related Bills: See Prior Analysis | Telephone: 845-7814 | Amended Date: February 11, 2009

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Low Income Housing Refundable Credit

____ 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 January 8, 2009, STILL APPLIES.

_X_ OTHER – See comments below.

SUMMARY

This bill would make the Low Income Housing Credit (LIHC) refundable, as specified.

SUMMARY OF AMENDMENTS

The February 11, 2009, amendments would do the following:

- Require the Tax Credit Allocation Committee (TCAC) to determine the financial closing date,
- Remove the definition of "financial closing,"
- Disallow the refundable credit from being carried over to future years,
- Exclude the credit from state taxation, and
- Exclude the credit from assignment under Revenue and Taxation Code (R&TC) section 23663.

As a result of the amendments, the "This Bill," "Implementation Concerns," and "Revenue Impact" discussions, as provided in the department's analysis of the bill as amended, January 8, 2009, have been revised. The amendments resolve the implementation concerns that were identified in the department's analysis dated January 8, 2009. The "Fiscal Impact" and "Policy Concerns" remain and have been included below for convenience.

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Patrice Gau-Johnson	03/19/09
____ N	____ OUA	_X_ PENDING		

ANALYSIS

THIS BILL

This bill would allow projects that receive a preliminary reservation of the state LIHC during calendar year 2008, for which financial closing has not occurred by the effective date of the bill, to be allocated to the partners of a partnership owning a low-income housing project. The allocation of the credit would be in accordance with the 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].

In addition, 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.

This bill would allow the LIHC to be refundable for projects that have received a preliminary reservation for a state low-income housing tax credit on or after July 1, 2008, and before January 1, 2011.

Currently, the TCAC allocates the LIHC to the taxpayer; the credit is applied to reduce taxes owed, and any remaining amount is carried over to reduce taxes in future years. Under this bill, after applying the credit to reduce taxes owed, the excess amount would be refundable. The refunds would be made after all tax liabilities, including, tax, penalties, interest, and fees, have been paid. The refundable amounts determined by FTB would be transferred from the Personal Income Tax Fund or Corporation Income Tax Fund to the Tax Relief and Refund Account. These funds are General Fund accounts.

The provisions of this bill would not apply if a “financial closing,” as determined by the TCAC, has occurred prior to the effective date of this bill.

This bill would disallow any refundable credits from being carried over into future years. In addition, any credit refunded to a taxpayer would be excluded from taxation under part 10 (commencing with section 17001) or part 11 (commencing with section 23001).

This bill would exclude projects that receive a LIHC from assignment pursuant to section 23663[2].

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

[2] Revenue and Taxation Code Section 23663 allows the assignment of certain credits to taxpayers under Corporation Tax Law that are members of a combined reporting group.

FISCAL IMPACT

This would be the first time the department has administered a refundable tax credit under the Corporation Tax Law (CTL). Staff estimates a combined a one-time cost of approximately $521,000 (4.3 PYs) to develop, program, and test the refundable credit processes in existing systems for both personal income tax and corporation tax. In addition, staff estimates ongoing costs that are absorbable to validate the credits reported on the tax return against pre-approved information from the TCAC.

TECHNICAL CONCERN

Amendment 1 has been provided to correct a technical error.

ECONOMIC IMPACT

Revenue Estimate

The revenue losses for this bill are as follows:

Refundable Low-Income Housing Credit Effective On or After ($ in Millions)			
Fiscal Year	2011-12	2012-13	2013-14
Refundable Low-Income Housing Credit	-$0.2	-$1.8	-$6.3

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

Revenue Discussion

Special Partnership Allocation Applied to 2008[3]

The revenue impact of the special partnership allocation being applied to preliminary reservations of state LIHC made during calendar year 2008 would be dependent on the increase in the rate at which those tax credits would be utilized (applied against state tax liabilities). The estimate assumes that state credits generated for eligible projects would experience a 25% faster utilization if allowed to be allocated separately from the federal credits.

[3] SB 585 (Stats. 2008, Ch.382) was enacted to allowed special partnership allocation rules for the LIHC.

This estimate relies on a residual credit value that was determined by analyzing historical data to compare credits allocated in one year and later applied against tax liabilities. Amounts remaining after the four-year credit window would be considered residual. This estimate reflects a three-year lag from preliminary credit reservation to the time when final project certification occurs by the TCAC. The initial revenue loss impact that would occur in fiscal year 2011-12 represents approximately 25% of a projected credit residual of $2.7 million. Based on TCAC data, this loss would be spread over the four-year credit window. An estimated $200,000 more of LIHC reserved during 2008 would be applied against tax liabilities over the four-year credit period, starting in 2011-12 ($2.7 million projected credit residual x 25% increased utilization x 27%[4] share in year 1 of 4 ≈ $200,000). This $200,000 revenue loss pattern would continue for the next two fiscal years. In the fourth fiscal year, 2014-15, the cash flow revenue loss would be reduced by approximately $50,000 because fewer credits would be distributed in the last year of the applicable four-year LIHC window.

Finally, in fiscal year 2022-23, it was assumed state LIHC recipients would realize additional revenue losses from the abandonment of a partnership interest. The amount of the corresponding revenue loss is estimated at approximately $250,000. This amount represents taxes that would be reduced by the deduction of abandonment losses by investors whose only tie to the partnership would be the state LIHC. This revenue loss is computed from the estimated portion of 2008 preliminary credits (approximately $2.7 million of the $84 million credit ceiling) that would be deemed allocated to investors who would walk-away after the requisite ten-year period specified under current law. As such, it is assumed taxpayers would claim abandonment losses of $2.7 million and a revenue loss of approximately $250,000 would result ($2.7 million x 8.84% tax rate).

Extend Refundable Low Income Housing Credit through 2010

The revenue impact of making the LIHC refundable would depend on the amount of LIHC refunded or applied to reduce tax liabilities under the proposal that otherwise would be applied several years later under current law. Relative to current law, more credits would be used sooner under the bill, offset by fewer credits claimed in later years.

Under current law, the analysis assumes that a significant percentage of preliminary credit reservations made during the specified 30-month period would be subsequently returned. Absent state legislation, it is assumed these returned credits would not be awarded until several years later when investor demand for low income housing projects returns to historical levels.

[4] Percentages as referenced in step #4.

Estimates were derived in the following steps:

1. Projected the LIHC awarded by the TCAC based on credits available annually under the state LIHC program for 2008 through 2010:

   Annual state credits available to be awarded are $83.8 million for 2008, $85.0 million for 2009, and $87.0 million for 2010. Based on TCAC data, available credits are multiplied by 96% to reflect the amounts that are awarded, resulting in $80.4 million for 2008 ($83.8 million x 0.96 ≈ $80.4 million), $81.6 million for 2009, and $83.5 million for 2010.

2. Adjusted the amount of awarded LIHC to reflect only eligible refund amounts:

   According to TCAC data, 72% of the 2008 preliminary reservations were made after 7/1/2008. Based on TCAC data, a 50% reduction adjustment is applied to eliminate projects for which a “financial closing” of a preliminary reservation occurs before 6/30/2009. Therefore, approximately $29 million in credits would be potentially subject to refund under the bill ($80.4 million estimated credits awarded in 2008 x 72% second round x 50% not yet “closed” by 6/30/2009 ≈ $29 million).

3. Projected the relevant amount of LIHC that would be awarded under current law, adjusted to account for the current economic downturn:

   Based on historical data, it is assumed that under <u>current</u> law, 20% of the preliminary credits reserved would be returned and awarded in subsequent years, starting with 2011. This reduces the potential base amount of final awards associated with the 2008 year to approximately $23 million ($29 million x .80).

4. Calculated the difference in applied credits under the bill and current law:
   Consistent with prior estimates, it is assumed there would be a four-year lag between the preliminary credit reservations in 2008 and when the credit is finally awarded in 2012. Of annual credits awarded, almost all are applied to reduce tax liabilities during the four-year credit period: 27% in each of the first three years (2012, 2013, and 2014) and the remaining 19% in the fourth year (2015).

The amount of 2008 preliminary credit reservations eligible for refund starting in 2012 is approximately $29 million. Of the $29 million assumed fully awarded, the amount that can be applied in the first year of the four-year credit period, 2012, is approximately $7.8 million (27% x $29 million ≈ $7.8 million). Under current law, of the economically adjusted $23.2 million of awarded credits originating from 2008, the amount projected to be applied in 2012 is $6.2 million (27% x $23.2 million ≈ $6.2 million). The difference in applied credits under these two scenarios is $1.6 million ($7.8 million - $6.2 million).

The revenue impact primarily results from the difference between 100% demand for available credits generated by this bill and only 80% demand for available credits under conditions of current law. Given the current economic downturn, the underlying assumption is that demand for these credits has decreased by 20%. It is anticipated that demand for LIHC would be restored to historical levels, causing more credits to be used sooner (i.e., refunded or applied to reduce tax liabilities).

Because taxpayers would not report refundable credits until the tax return for 2012 is filed, the entire $1.6 million of the initial fiscal year impact does not occur until fiscal year 2012-13. Under the same methodology as described above, the revenue losses would be approximately $6 million in 2013-14, $10.5 million in 2014-15, $8.5 million in 2015-16, and $1.7 million in 2016-17. Relative to current law, more credits would be claimed sooner under proposed law, offset by fewer credits claimed in later years. Starting in 2017-18, there would be revenue gains that offset the prior years' losses.

Exempt Refund From Taxation

The revenue impact would depend on how much the low income housing credit is refunded to taxpayers claiming the credit. Only the refundable portion of the credit would be considered taxable income under current law. This estimate assumes taxpayers who obtain refundable low-income housing credits would be able to apply 40% of the credits against tax liabilities. Assuming a marginal tax rate of 8%, the revenue loss to exclude refunded credits from income would be $75,000 in fiscal year 2013-14, $287,000 in 2014-15, and $504,000 in 2015-16.

For the initial impact year 2013-14, the revenue loss is projected as follows:

- Amount of additional low-income housing credits generated (because of the refundable aspect) from 2008 preliminary reservations that can be first applied in 2012-13 ≈ $1.6 million (step 4 above)
- Amount that could be offset against 2012 tax liabilities would be approximately, $630,000 ($1.6 million 2008 generated credits x 40% credits applied against tax liability)
- Balance that would be refunded in 2012 would be approximately $940,000 ($1.6 million 2008 generated credits - $630,000 offset against 2012 tax liabilities)
- Tax on $940,000 included as income in the 2013 taxable year would be approximately $75,000 ($940,000 refunded in 2012 x 8% marginal tax rate)

It is estimated that the $75,000 revenue loss would be in addition to the $6.2 million loss detailed in the department's analysis dated January 8, 2009, for a total revenue loss of $6.3 million in 2013-14.

POLICY CONCERNS

The department is concerned with the possibility of fraud. Historically, refundable credits (such as the state renter's credit, the federal Earned Income Credit, and the federal credit for gasoline used for farming) have had significant problems with invalid and fraudulent returns. Although the LIHC would be verified by a third party, the TCAC, at the partnership entity level, the possibility of fraud remains at the partner level when a personal income tax return is filed by a partner.

In addition, this bill would set a precedent for business tax credits by allowing the LIHC to be refundable under the CTL.

LEGISLATIVE STAFF CONTACT

Legislative Analyst	Revenue Director	Asst. Legislative Director
Angela Raygoza	Jay Chamberlain	Patrice Gau-Johnson
(916) 845-7814	(916) 845-3375	(916) 845-5521
angela.raygoza@ftb.ca.gov	jay chamberlain@ftb.ca.gov	patrice.gau-johnson@ftb.ca.gov

Analyst Angela Raygoza
Telephone # 845-7814
Attorney Patrick Kusiak

FRANCHISE TAX BOARD’S
PROPOSED AMENDMENTS TO SB 16
As Amended February 11, 2009

AMENDMENT 1

On page 6, line 15, strike "23633" and insert:

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