Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Lowenthal	Analyst:	Angela Raygoza	Bill Number:	SB 622
Related Bills:	See Legislative History	Telephone:	845-7814	Amended Date:	May 21, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Low Income Housing Credit/Allocation To Partners According To Partnership Agreement/Extends to Projects That Receive Preliminary Reservation During 2008 Calendar Year

SUMMARY

This bill would extend the special partnership credit allocation rules for the Low Income Housing Credit (LIHC), as specified.

SUMMARY OF AMENDMENTS

The May 21, 2009, amendments would do the following:

- Remove language that would have modified the Health and Safety Code,
- Add language that would extend the special partnership credit allocation rules, as specified, and
- Provide that the bill's provisions do not apply if a financial closing, with respect to the low-income housing project, as determined by the California Tax Credit Allocation Committee (TCAC), has occurred prior to the effective date of this bill.

This analysis will not address the bill's changes to the Insurance Tax Law, as they do not impact the department or state income tax revenue.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

The bill language addressing the reasons for urgency indicates that the purpose of this bill is to prevent low-income housing project developers from returning unused credits because of the financial downturn and to entice investors back into affordable housing until the financial market stabilizes.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment. The language specifies that the special allocation rules would be specifically operative for projects that received a preliminary reservation during calendar year 2008 for which financial closing has not occurred as of the effective date.

Board Position:			Department Director	Date
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POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal tax law allows a LIHC for the costs of constructing, rehabilitating, or acquiring low-income housing. The credit amount varies depending on several factors, including when the housing was placed in service and whether it was federally subsidized. The credit is claimed over ten years. TCAC has the authority to oversee the process and allocate the federal and state credit.

Current state tax law generally conforms to federal law with respect to the LIHC, except that the state LIHC is claimed over four taxable years, is limited to projects located in California, and is allocated in amounts equal to the sum of all the following:

- For calendar year 2009, the amount of LIHC available is $85 million.[1]
- The unused housing credit ceiling, if any, for the preceding calendar year.
- The amount of housing credit ceiling returned in the current calendar year.

Current federal and state income tax law requires a partner's distributive share of income, gain, loss, deduction, or credit to be determined in accordance with the partner's interest in the partnership by taking into account all facts and circumstances if one of the following occurs:

- The partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit; or
- The allocation of income, gain, loss, deduction, or credit to a partner under the partnership agreement does not have substantial economic effect.

As an exception to the requirements above, under state tax law, for a project that receives a preliminary reservation of the LIHC on or after January 1, 2009, and before January 1, 2016, the LIHC may be allocated to the partners of a partnership owning a low-income housing project in accordance with the provisions of 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, within the meaning of Internal Revenue Code (IRC) section 704(b) [2].

In addition, state tax law requires a deferral of any loss or deduction from the sale or disposition of a partnership interest where the LIHC was allocated without substantial economic effect until the first taxable year immediately following the end of the ten-year credit period for which the federal credit is allowed.

[1] This amount is adjusted annually based on the Consumer Price Index (CPI) for the preceding calendar year.
[2] RC section 704(b) defines a partner's distributive share when a proposed allocation under a partnership agreement lacks substantial economic effect.

THIS BILL

This bill would allow projects that received 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[3].

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.

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.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department’s programs and operations.

LEGISLATIVE HISTORY

SB 16 (Lowenthal, 2009/2010) is similar to this bill as SB 16 would make the LIHC refundable and would extend the partnership allocation rules for the preliminary reservation of the state LIHC during tax year 2008. This bill is currently in the Senate Appropriations suspense file.

SB 585 (Stats. 2008, Ch. 385) requires a project that receives a preliminary reservation of the LIHC on or after January 1, 2009, and before January 1, 2016, to have the LIHC 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 under IRC section 704(b). In addition, SB 585 requires 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 for which the federal credit is allowed.

SB 1247 (Stats. 2008, Ch. 521) repealed the farmworker housing credit from the Revenue and Taxation Code and requires the Farmworkers Housing Credit (FWHC) to be allocated in the same manner as the state low-income housing tax credit. This act specifies that the $500,000 annual cap plus any unallocated credit under current law is exclusively for farmworker housing. SB 1247 allows any FWHC that is unallocated or returned to be added to the annual credit allocation cap until exhausted. This act also allows the FWHC to be awarded independently of the federal LIHC.

[3] Ibid

OTHER STATES' INFORMATION

The change proposed by this bill would not alter the underlying tax aspects of the credit, so a comparison with other states' tax laws would not be relevant.

FISCAL IMPACT

This bill would not impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue losses would be as follows:

SB 622 (Lowenthal) – As Amended May 21, 2009 Allow Special Partnership Allocation For 2008 Effective For Preliminary Reservations Made During Calendar Year 2008 Enactment Assumed On or After June 30, 2009						
Fiscal Year	2008-09	2009-10	2010-11	2011-12	2012-13	2013-2014
Revenue Loss	No impact	No impact	No impact	-$70,000	-$70,000	-$70,000

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

Revenue Discussion

The revenue impact of this bill to extend the special partnership allocation rules to preliminary reservations of a state LIHC made during calendar year 2008 would depend on the increase in the rate at which those tax credits would be applied against state tax liabilities.

This estimate assumes that state LIHCs generated for eligible projects would experience a 25 percent increase in utilization if allocated separately from the federal credits. The losses in revenue would be offset by gains in future years, resulting in an increase in revenue in the years when the accelerated credits would have been reported. Over time, the revenue loss would be insignificant.

Based on TCAC data, approximately $80.8 million in credits are projected to be awarded during the 2008 calendar year. The amount of credits eligible for the special partner allocation treatment depends on the amount of projects that are not financially closed as of the effective date of this bill, which is assumed to be June 30, 2009. Using supplemental TCAC data and discussions with TCAC staff, it was assumed that approximately one out of three projects awarded credits during 2008 would not have financially closed on the project as of June 30, 2009. It is assumed that each of these projects would financially close and be eligible for the special partner allocation rules.

Assuming one-third of the $80.8 million in state LIHCs would ultimately be assigned to state-only investors this would yield approximately $26.6 million in credits ($80.8 million in credits x 33%). Generally, these credits are claimed over a four-year credit period, beginning approximately three years from when the credits are first awarded on a preliminary basis.

Based on TCAC data and department data, it was determined that approximately four percent of the state LIHC remains unapplied after the four-year credit period. Of the $26.6 million in credits, the residual amount of unapplied credits after four years is approximately $1.06 million ($26.6 million x 4% residual). This analysis assumes that 25 percent of this amount would be claimed at an increasing rate when a state-only LIHC investor is involved. Approximately $266,000 more credits would be applied ($1.06 million in residual credits x 25%), at a rate of 27 percent in the first three years and 19 percent in year four. Thus, for 2011-12 through 2013-14, approximately an additional $70,000 in state LIHC would be applied ($266,000 applied credits x 27%).

Finally, in fiscal year 2022-23, it was assumed that a state-only LIHC credit recipient would realize additional revenue losses from the abandonment of a partnership interest. The amount of the corresponding revenue loss is estimated at approximately $20,000 ($266,000 applied credits x 9% marginal tax rate). The $20,000 revenue loss represents taxes reduced by the deduction of abandonment losses by investors whose only tie to the LIH development partnership was the state LIHC credit.

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