Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Beall	Analyst:	Jessica Deitchman	Bill Number:	SB 377
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Dates:	April 6, & April 16, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Low Income Housing Credit

SUMMARY

This bill would modify the existing Low-Income Housing Credit (LIHC) to remove the sunset, and to add provisions to allow the credit to be sold.

This analysis only addresses the provisions of this bill that impact the department's programs and operations.

RECOMMENDATION

No position.

Summary of Amendments

The April 6, 2015, and April 16, 2015, amendments removed the provisions of the bill as introduced February 24, 2015, relating to "affordable housing" and replaced them with the provisions discussed in this analysis.

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

REASON FOR THE BILL

The reason for the bill is to increase the impact of the state's existing low-income housing tax credit with no fiscal impact to the state by structuring the credits in a way that is not subject to federal taxation.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2016.

FEDERAL/STATE LAW

Current federal tax law allows an 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 and varies between 30 and 70 percent of the present value of the qualified low-income housing. The credit is claimed over ten years.

Board Position:			Executive Officer	Date
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The California Tax Credit Allocation Committee[1] (Allocation Committee) allocates and administers the federal and state LIHC Programs.

Current state tax law generally conforms to federal law (Section 42 of the Internal Revenue Code) with respect to the LIHC, except that the state LIHC is claimed over four taxable years (10 years for federal), is limited to projects located in California, must be allocated and authorized by the Allocation Committee, rents must be maintained at low-income levels for 30 years (15 years for federal), and the Allocation Committee must have authorized a federal credit to the taxpayer or the taxpayer must qualify for the federal credit. The LIHC is allocated in amounts equal to the sum of all the following:

- For calendar years ending 2002 and thereafter, $70 million increased by the percentage by which the Consumer Price Index (CPI), for the preceding calendar year, exceeds the CPI for the 2001 calendar year,
- The unused housing credit ceiling, if any, for the preceding calendar years, and
- The amount of housing credit ceiling returned in the calendar year.

Existing law requires allocation of the LIHC, on or after January 1, 2009, and before January 1, 2016, to partners based upon 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, as specified.

The Allocation Committee certifies the amount of tax credit amount allocated. In the case of a partnership or an S Corporation, a copy of the certificate is provided to each taxpayer. The taxpayer is required, upon request, to provide a copy of the certificate to the Franchise Tax Board (FTB).

Any unused credit may continue to be carried forward until the credit is exhausted.

Existing federal and state laws provide that gross income includes all income from whatever source derived, including gains from property unless specifically excluded.

The sale of a credit is a sale of property, therefore, the seller is required to report gain from the sale. The gain from the sale of the credit is the excess of the total consideration received over the basis. The total amount of consideration received is the sum of any money received plus the fair market value of the property (other than money) received. Since the seller's basis in the credit is $0 (zero), the seller will recognize and report gain on the full amount of consideration received.

[1] Voting members of this committee are the State Controller, the State Treasurer and the Director of Finance.

THIS BILL

This bill would extend in perpetuity, the requirement that allocation of the LIHC to partners be based upon the partnership agreement, regardless of how the Federal LICH is allocated to the partners, or whether the allocation has substantial economic effect, as specified.

Additionally, for any LIHC credits awarded for taxable years beginning on or after January 1, 2016, a taxpayer may make an irrevocable election in its application to the Allocation Committee to sell all or any portion of any LIHC allowed to one or more unrelated parties for each taxable year in which the LIHC is allowed for consideration that is not less than 80 percent of the amount of the credit. Sales of LIHC would be subject to the following:

- The sale may be documented based on any method selected by the taxpayer that originally receives the credit.
- The sale may be changed for any subsequent taxable year if the sale is expressly shown on each of the returns of both the transferor and the transferee that sell and receive the credit.
- The taxpayer that originally received the credit would report to the Allocation Committee prior to the sale of the credit, in the form and manner specified by the Allocation Committee, all required information regarding the purchase and sale of the credit, including:
    - The social security or other taxpayer identification number of the unrelated party to whom the credit has been sold,
    - The face amount of the credit sold, and
    - The amount of consideration received by the taxpayer for the sale of the credit.
- A credit could be sold to more than one unrelated party, and could not be resold by the unrelated party to another taxpayer or other party.
- The taxpayer that originally received the credit that is sold would remain solely liable for all obligations and liabilities imposed on the taxpayer with respect to the credit this bill amends; none of which would apply to any party to whom the credit has been sold or subsequently transferred.
- Parties who purchase credits, would be entitled to utilize the purchased credits in the same manner that taxpayer that originally received the credit could utilize them.
- A taxpayer could not sell a credit if the taxpayer was allowed the credit on any tax return of the taxpayer.

The taxpayer, with the approval of the Executive Director of the Allocation Committee, may rescind the election to sell all or any portion of the credit allowed if the consideration for the credit falls below 80 percent of the amount of the credit after the Allocation Committee reservation.

Because the income is not specifically excluded from income, the gain to the seller from the sale of the credit would be included in taxable income as a capital gain.

The bill requires the Allocation Committee to provide an annual listing to the FTB, in a form agreed to by the FTB and the Allocation Committee, of the taxpayers that have sold or purchased a credit allowed by this bill.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill uses the terms "transferor" and "transferee", which could be interpreted differently than the author's intent. For clarity it is recommended the bill be amended to use the more common terms "seller" and "purchaser."

Because the bill fails to specify otherwise, the FTB would be subject to the rulemaking procedures required under the Administrative Procedures Act (APA).[2] Following these procedures may delay the immediate implementation of this bill. To prevent any delay, it is recommended that the author add a provision exempting the FTB from the APA when the FTB is prescribing rules, guideline, or procedures necessary or appropriate to carry out the purpose of this bill.

LEGISLATIVE HISTORY

AB 35 (Chiu and Atkins, 2015/2016) would modify the existing LIHC to increase the annual amount that may be allocated. AB 35 is pending before the Assembly Revenue and Taxation Committee.

AB 952 (Atkins, Chapter 771, Statutes of 2013), amended the existing LIHC to allow the state's Housing Credits to be used in a Difficult Area or Tract for projects that dedicate at least 50 percent of the project's units to be reserved for special needs populations as defined by the Committee regulations, allow the committee to replace the federal Housing Credit with a state Housing Credit of up to 30 percent of a project's eligible basis, if the federal Housing Credit is reduced in an equivalent amount, and to require the Committee to determine what an equivalent amount of state Housing Credit is necessary to replace the federal Housing Credit a taxpayer would have received.

SB 16 (Lowenthal, 2009/2010), would have made the LIHC refundable and would have extended the partnership allocation rules for the preliminary reservation of the state LIHC during tax year 2008. SB 16 failed passage out of the Senate by the constitutional deadline.

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[2] [1] Government Code section 11340 et seq.

SB 622 (Lowenthal, 2009/2010), would have allowed 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. SB 622 failed passage out of the Senate by the constitutional deadline.

SB 585 (Lowenthal, Chapter 382, Statutes of 2008), 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 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 Internal Revenue Code 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 (Lowenthal, Chapter 521, Statutes of 2008), repealed the farmworker housing credit (FWHC) from the Revenue and Taxation Code and requires the FWHC to be allocated in the same manner as the state LIHC. 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.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida, Michigan, and *Minnesota*, lack a state LIHC.

Illinois currently offers a state LIHC program that is funded on donations made to the program. A state tax credit is available at 50 cents for every dollar donated. Donors may transfer some or all of their *Illinois* LIHC (to another individual or entity). The individual or entity receiving the credit must make a donation to the affordable housing project at the time of transfer. If the amount transferred is less than $100,000, the donation must be 10 percent of the amount transferred. The donation must be $10,000 for amounts $100,000 and greater. The administrating agency must be informed in writing of all *Illinois* LIHC transfers.

Massachusetts[3], offers a state LIHC. Developers of affordable rental housing developments apply to the Department of Housing and Community Development for tax credits. If they are awarded the credit, the developers (either for-profit or nonprofit) seek investors to help pay for the development of the housing. Intermediaries (known as syndicators) act as a bridge between investors and projects and often pool investors' money into equity funds. In exchange for providing development funds, the investors receive a stream of tax credits.

New York[4] provides a LIHC for developers who acquire, build or rehabilitate low-income rental housing. Developers sell these 10-year tax credits to investors for capital to fund additional construction.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 377 As Amended April 16, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $3.7	- $9.8	- $10

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill. In addition, this estimate only reflects the revenue impact to income and franchise taxes.

Revenue Discussion:

Using LIHC allocation data from the California Tax Credit Allocation Committee it is estimated that approximately $100 million, after inflation indexing would be available for allocation in 2016. Based on current credit awards and usage it is estimated that 10 percent, or $10 million, of the annual credits would be sold, with the remaining 90 percent to be used against income, franchise,

[3] Currently capped at $20,000,000 per calendar year.
[4] Not currently allocated on a calendar year basis.

and insurance taxes. It is assumed that the ability to sell the credit would result in a timing difference. Credits sold would be used in the year purchased, accelerating the credit usage loss relative to current law. For credits that are sold, it is assumed that the taxpayer would have additional capital gain income in the amount of 80 percent of the value of the credits sold. Current usage indicates that 98 percent would be claimed by corporations and the remaining 2 percent would be claimed by personal income taxpayers.

Combining the accelerated credit usage and the offsetting tax from capital gains, it is estimated the average annual revenue loss for income and franchise tax would be approximately $10 million per year. The tax year estimates are converted to fiscal year estimates, and then rounded and reflected in the table above.

SUPPORT/OPPOSITION

Support: California State Treasurer John Chiang (Co-Sponsor), California Housing Partnership Corporation (Co-Sponsor), California Coalition for Rural Housing (CCRH), California Reinvestment Coalition, , Charities Housing, Chinatown Community Development Center, Community Action North Bay (CAN-B), Community Economics Inc., Housing California, LINC Housing, Non-Profit Housing Association of Northern California (NPH), Peoples' Self-Help Housing.

Opposition: None provided.

ARGUMENTS

Proponents: Some could argue that allowing the Low-Income Housing Credit to be sold to unrelated parties could free up additional capital for investors and would increase the inventory of low-income housing.

Opponents: Some could argue that this bill would increase economic disparity within the state by continuing to concentrate on the rehabilitation of low-income housing while ignoring other areas of housing that may need additional incentives to encourage development.

LEGISLATIVE STAFF CONTACT

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