BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Beall**	**SB 377**

SUBJECT

Low-Income Housing Credit

SUMMARY

This bill would modify the existing Low-Income Housing Credit (LIHC), and 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.

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. The provision of this bill related to elections to sell the LIHC would be specifically operative for projects that receive a preliminary reservation beginning on or after January 1, 2016, and before January 1, 2026.

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.

The California Tax Credit Allocation Committee[1] (Allocation Committee) allocates and administers the federal and state LIHC Programs.

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

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9/16/15

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:

- $100 million, [2]
- 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.

[2] The statutory $70 million allocation amount adjusted by the Consumer Price Index (CPI) through 2015.

BACKGROUND

California law, as discussed above, currently provides a LIHC. FTB data for tax year 2012, the most recent year data is available, provides the following information for the California LIHC.

LIHC Personal Income Tax (PIT) 2012:

Adjusted Gross Income Class	Returns Allowing Credit	Amount of Credit Allowed (Thousands)
Less than $10,000	3	$0.1
$10,000 to $19,999	7	$0.5
$20,000 to $49,999	60	$21.5
$50,000 to $99,999	95	$51.7
$100,000 to $199,999	58	$65.4
$200,000 to $499,999	49	$82.4
$500,000 to $999,999	28	$63.3
More than $999,999	34	$356.5
Total	334	$641.3

LIHC Allowed by Industry (Corporation): 2012				
Industry	Returns with Credit		Percent of Total	
	Returns Allowing Credit	Amount of Credit Allowed (Millions)	Returns	Credit Allowed
Finance and Insurance	6	$6.8	31.6%	21.2%
Real Estate	3	$0.1	15.8%	0.3%
Other	10	$25.1	52.6%	78.5%
Total	19	$32.0	100.0%	100.0%

THIS BILL

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

Additionally, for a project that receives a preliminary reservation beginning on or after January 1, 2016 and before January 1, 2026, 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 subject to the following conditions:

- A credit is sold for consideration that is not less than 80 percent of the amount of the credit.
- The unrelated party or parties purchasing any or all of the credit, is a taxpayer allowed the state or federal[3] LIHC for the taxable year of the purchase or any prior taxable year in connection with a project located in this state. "Taxpayer allowed the credit" means a taxpayer that is allowed the credit without regard to the purchase of a credit.

The taxpayer that originally receives the credit would report to the Allocation Committee within 10 days of the sale, 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.

The Allocation Committee would provide an annual listing to the FTB, in a form and manner agreed upon by the Allocation Committee and the FTB, of the taxpayers that have sold or purchased a credit.

A credit could be sold to more than one unrelated party, but could not be resold by the unrelated party to another taxpayer or other party. All or any portion of any credit allowed may be resold once by an original purchaser to one or more unrelated parties, subject to all the requirements of the LIHC.

[3] Allowed under section 42 of the Internal Revenue Code.

The taxpayer that originally receives the credit that is sold would remain solely liable for all obligations and liabilities imposed on the taxpayer with respect to the credit, 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 the 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 falls below 80 percent of the amount of the credit after the Allocation Committee reservation.

The bill would require the Allocation Committee to enter into an agreement with the FTB to pay any costs incurred by the FTB in the administration 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 was enrolled on September 14, 2015.

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.

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[4], 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.

[4] Currently capped at $20,000,000 per calendar year.

New York[5] 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

This bill would require the department to be reimbursed for costs incurred as a result of implementing this bill and it is anticipated that the costs will be insignificant.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of SB 377 Assumed Enactment After June 30, 2015		
2015-16	2016-17	2017-18
+ $70,000	+ $200,000	- $100,000

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 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 4 percent, or $4 million, of the annual credits would be sold, with the remaining 96 percent used against income, franchise, and insurance taxes. It is assumed that the ability to sell the credit would result in a timing difference. However, because credits sold cannot be used until the building is put into service, the acceleration of credit use relative to current law will not begin until 2018, two years after the credit allocation. The revenue impact of the accelerated credit usage would not be fully phased in until taxable year 2021, since credits must be taken over a four year period. 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. This capital gain income must be claimed in the year the credits are purchased, which results in a positive revenue impact for the 2016 and 2017 taxable years.

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[5] Not currently allocated on a calendar year basis.

Combining the accelerated credit usage (relative to current law) and the offsetting capital gains tax, it is estimated the average annual revenue loss for income and franchise tax would be approximately $400,000 in 2018, increasing to $2 million in 2021. Current usage indicates that 98 percent would be claimed by corporations and the remaining 2 percent would be claimed by personal income taxpayers.

The tax year estimates are converted to fiscal year estimates, and then rounded and reflected in the table above.

APPOINTMENTS

None.

SUPPORT/OPPOSITION

Support: California Tax Credit Allocation Committee, State Treasurer John Chiang, Burbank Housing Management Corporation, C&C Development Corporation, California Association of Housing Authorities, California Association of Local Housing Finance Agencies, California Coalition for Rural Housing, California Commission on Aging, California Housing Partnership Corporation, California Institute for Rural Studies, California Land Title Association, Charities Housing, Chinatown Community Development Center, Christian Church Homes, City Heights Community Development Corporation, City of Morgan Hill, Community Action North Bay, Community Economics, EAH Housing, East Bay Asian Local Development Corporation, East Bay Housing Organizations, Eden Housing, Housing California, Integrity Housing, Leadership Counsel for Justice and Accountability, Linc Housing, MidPen Housing Corporation, Mogavero Notestine Associates, Monterey County Supervisor Jane Parker, Mutual Housing California, Northern California Community Loan Fund, Paulett Taggart Architects, Peoples' Self-Help Housing, Public Interest Law Project, Rural Communities Housing Development Corporation, San Diego Habitat for Humanity, San Diego Housing Federation, San Diego-Imperial Counties Labor Council, San Luis Obispo Housing Trust Fund, Satellite Affordable Housing Associates, Self-Help Enterprises, Sierra Business Council, Sonoma County Task Force for the Homeless, Tenderloin Neighborhood Development Corporation, Terrex Development Corporation, The Hampstead Companies, The Nonprofit Housing Association of Northern California, Wakeland Housing and Development Corporation, Two Individuals.

Opposition: None provided.

VOTES

	Date	Yes	No
Concurrence	09/11/15	38	0
Assembly Floor	09/11/15	79	0
Senate Floor	006/02/15	38	1

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