BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Committee on Budget and Fiscal Review**	**SB 837**

SUBJECT

Low-Income Housing Credit / Fresh Fruits and Vegetables Credit

SUMMARY

This bill would do the following:

- Provision 1: Modify the existing Low-Income Housing Credit (LIHC) under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL) and add provisions to allow the credit to be sold.
- Provision 2: Create a new Donated Fresh Fruits and Vegetables Credit (Fruits and Vegetables Credit) under the PITL and the CTL.

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 two provisions are addressed separately below.

EFFECTIVE/OPERATIVE DATE

As a bill with an appropriation related to the budget and identified as related to the budget in the Budget Bill, this bill would be effectively immediately upon enactment. The operative dates of each of the two provisions are addressed separately below.

ECONOMIC IMPACT - SUMMARY REVENUE TABLE

	2016-17	2017-18	2018-19
Provision 1: LIHC	+ $300,000	- $100,000	- $700,000
Provision 2: Fruits and Vegetables Credit	- $500,000	- $1,000,000	- $1,200,000

PROVISION 1: Modify the Existing LIHC

REASON FOR THE PROVISION

The reason for this provision is to increase the impact of the state's existing LIHC with no fiscal impact to the state by structuring the LIHC in a way that is not subject to federal taxation.

EFFECTIVE/OPERATIVE DATE

This provision would be effective immediately upon enactment and specifically operative for projects that receive a preliminary reservation 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 is placed in service and whether it is 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.

Current state tax law generally conforms to federal law (Internal Revenue Code section 42) with respect to the LIHC, except that the state LIHC is claimed over four taxable years (versus 10 years for federal purposes), 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 (versus 15 years for federal purposes), 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.

Prior law required 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 was allocated to the partners, or whether the allocation of the credit under the terms of the agreement had substantial economic effect, as specified.

---

[1] Voting members of this committee are the State Controller, the State Treasurer, and the Director of Finance.
[2] The statutory $70 million allocation amount adjusted by the Consumer Price Index (CPI) through 2015.

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. Because the seller's basis in the credit is zero, the seller will recognize and report gain on the full amount of consideration received.

THIS PROVISION

For a project that receives a preliminary reservation of the state LIHC before January 1, 2020, this provision would re-enact the prior-law exception that allows the LIHC to be allocated among partners based upon the partnership agreement, regardless of how the federal LIHC is allocated to the partners, or whether the allocation under the terms of the partnership agreement 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, 2020, a taxpayer would be allowed to 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 both of the following conditions:

- An LIHC is sold for consideration that is not less than 80 percent of the amount of the credit, and
- The unrelated party or parties purchasing any or all of the LIHC, 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" would mean a taxpayer that is allowed the credit without regard to the purchase of a credit.

The taxpayer that originally receives the LIHC 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 LIHC, including:

  - The social security or other taxpayer identification number of the unrelated party to whom the LIHC has been sold,

---

[3] Allowed under Internal Revenue Code (IRC) section 42.

- The face amount of the LIHC sold, and
- The amount of consideration received by the taxpayer for the sale of the LIHC.

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 an LIHC.

The LIHC 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 LIHC allowed may be resold once by an original purchaser to one or more unrelated parties, subject to all the requirements of the LIHC.

The taxpayer that originally receives the LIHC that is sold would remain solely liable for all obligations and liabilities imposed on the taxpayer with respect to the LIHC, none of which would apply to any party to whom the LIHC has been sold or subsequently transferred. Parties who purchase an LIHC would be entitled to utilize the purchased LIHC in the same manner the taxpayer that originally received the LIHC could utilize them.

A taxpayer could not sell the LIHC 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, would be allowed to rescind the election to sell all or any portion of the LIHC allowed if the consideration falls below 80 percent of the amount of the LIHC after the Allocation Committee reservation.

This provision 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 the sale of LIHCs.

LEGISLATIVE HISTORY

SB 873 (Beal, 2015/2016), substantially similar to this provision, would modify the existing LIHC to allow the sale of the credit to unrelated parties. SB 873 is currently in the Assembly Revenue and Taxation Committee.

SB 377 (Beal, 2015/2016), substantially similar to this provision, would have modified the existing LIHC to allow the sale of the credit to unrelated parties. SB 377 was vetoed by Governor Brown on October 10, 2015, because “despite strong revenue performance over the past few years, the state’s budget has remained precariously balanced due to unexpected costs and the provision of new services. Now, without the extension of the managed care organization tax that I called for in special session, the next year’s budget faces the prospect of over $1 billion in cuts. Given these financial uncertainties, I cannot support providing additional tax credits that will make balancing the state’s budget even more difficult. Tax credits, like new spending on programs, need to be considered comprehensively as part of the budget deliberations.”

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 had 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 is owned by a partnership that receives a preliminary LIHC reservation on or after January 1, 2009, and before January 1, 2016, to allocate the LIHC 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.

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 transfers of amounts equal to or exceeding $100,000. The administering 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 an 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 provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of SB 837 Provision 1: LIHC Assumed Enactment by June 30, 2016		
2016-17	2017-18	2018-19
+ $300,000	- $100,000	- $700,000

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 California Tax Credit Allocation Committee, it is estimated that approximately $100 million in LIHC would be available for preliminary reservations 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 because credits sold cannot be used until the building is put into service and the acceleration of credit use relative to current law would 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 (because credits must be taken over a four-year period). The fully phased-in revenue loss would be $2 million in 2021.

Additionally, 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 would result in a positive revenue impact for the 2016 and 2017 taxable years.

---

[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: None provide.

Opposition: None provided.

<u>PROVISION 2: New Fruits and Vegetables Credit</u>

REASON FOR THE PROVISION

The reason for this provision is to encourage additional donations to food banks by creating a new tax credit.

EFFECTIVE/OPERATIVE DATE

This provision would be effective immediately upon enactment and specifically operative for donations of fresh fruits or fresh vegetables to a food bank located in California for taxable years beginning on or after January 1, 2017, and before January 1, 2022.

FEDERAL/STATE LAW

Under current federal law, in general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of any deduction generally equals the fair market value of the contributed property on the date of the contribution.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory. Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, and the donor's basis may still be recovered by the donor as a business deduction other than as a charitable contribution.

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.

California's PITL generally conforms to the federal rules relating to charitable contributions as of the specified date of January 1, 2009, but specifically does not conform to the enhanced deduction for a contribution of food inventory. The deduction under the PITL for charitable contributions of inventory is limited to the taxpayer's basis in the inventory, generally its cost. Additionally, the state's CTL does not adopt the general federal rules that allow enhanced deductions for C-corporation contributions of inventory, and does not adopt the enhanced deduction for a contribution of food inventory. The deduction under the CTL for contributions of inventory is limited to the taxpayer's basis in the inventory (generally its cost), and may not exceed ten percent of the corporation's net income. Any excess may be carried forward for up to five years.

For taxable years beginning before January 1, 2017, current state law allows a credit of 10 percent[6] of the qualified donation of fresh fruits and vegetables made to a qualified nonprofit by a qualified taxpayer.[7]

THIS PROVISION

This provision would, under the PITL and the CTL, for taxable years beginning on or after January 1, 2017 and before January 1, 2022, allow a credit to a qualified taxpayer who donates fresh fruits or vegetables to a food bank located in California.[8] The credit allowed would be equal to 15 percent of the qualified value of those fresh fruits and vegetables.

The provision would define the following:

- "Qualified taxpayer" would mean the person responsible for planting a crop, managing the crop, and harvesting the crop from the land.
- "Qualified value" would be calculated by using the weighted average wholesale price based on:
    - The qualified taxpayer's total like grade wholesale sales of the donated item sold within the calendar month of the qualified taxpayer's donation or,
    - If no wholesale sales of the donated item have occurred in the calendar month of the qualified taxpayer's donation, the "qualified value" would be equal to the nearest regional wholesale market price for the calendar month of the donation based upon the same grade products as published by the United States Department of Agriculture's Agricultural Marketing Service or its successor.

Any deduction otherwise allowed for the cost paid or incurred by the qualified taxpayer for the donated items would be reduced by the amount of the credit allowed. The donor would be

---

[6] Of the cost that would otherwise be included in inventory costs under IRC section 263A, or that would be required to be included in inventory costs under IRC section 263A.
[7] Qualified taxpayer means the person responsible for planting a crop, managing a crop, and harvesting the crop from the land.
[8] Under Chapter 5 (commencing with Section 58501) of Part 1 of Division 21 of the Food and Agricultural Code.

required to provide to the nonprofit organization the qualified value of the donated fresh fruits or fresh vegetables and information regarding the origin of where the donated fruits or vegetables were grown, and upon receipt of the donated fresh fruits or fresh vegetables, the nonprofit organization would provide a certificate to the donor. The certificate would contain a statement signed and dated by a person authorized to sign on behalf of the food bank, and the type and quantity of product donated, the name of the donor or donors, the name and address of the donee nonprofit organization, and as provided by the donor, the qualified value of the donated fresh fruits and vegetables and its origins. Upon request, the qualified taxpayer would be required to provide a copy of the certification to the FTB.

The credit allowed could be claimed only on a timely-filed original return.

The credit could be carried over for up to seven years, or until exhausted.

In accordance with Revenue & Taxation Code section 41, the purpose of the credit is to increase fresh fruits and vegetable donations to food banks. Using the information available to the FTB from the certificates required, the FTB would be required to report to the Legislature on or before December 1, 2019, and each December 1 thereafter the utilization of the credit authorized by this provision. The FTB would also include the qualified value of the fresh fruits and fresh vegetables donated, the county in which the products originated, and the month the donation was made. The reporting requirement would become inoperative on January 1, 2021.

This provision would be repealed on December 1, 2022.

LEGISLATIVE HISTORY

AB 515 (Eggman, et al., 2015/2016) would have recast the existing Donated Fresh Fruits or Vegetables Credit as an Agriculture Product Donation to Food Bank Credit. AB 515 was vetoed by Governor Brown on October 10, 2015, because “despite strong revenue performance over the past few years, the states’ budget has remained precariously balanced due to unexpected costs and the provision of new services. Now, without the extension of the managed care organization tax that I called for in special session, the next year’s budget faces the prospect of over $1 billion in cuts. Given these financial uncertainties, I cannot support providing additional tax credits that will make balancing the state’s budget even more difficult. Tax credits, like new spending on programs, need to be considered comprehensively as part of the budget deliberations.”

AB 152 (Fuentes, et al., Chapter 503, Statutes of 2011) created the Donated Fresh Fruits or Vegetables Credit under the PITL and the CTL. This credit allows a 10-percent credit for donations of fresh fruits and vegetables made to a qualified nonprofit entity and is operative for taxable years beginning on or after January 1, 2012, and before January 1, 2017.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states lack a credit similar to the credit proposed in this provision. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

ECONOMIC IMPACT

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 837 Provision 2: Fruits and Vegetables Credit Assumed Enactment by June 30, 2016		
2016-17	2017-18	2018-19
- $500,000	- $1,000,000	- $1,200,000

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Based on tax-return data for the current Fruits and Vegetables Credit, qualified taxpayers made $5.3 million in qualified donations in 2014. The estimate is adjusted to reflect changes in the economy over time and results in an estimated $7 million of food donations in 2017. The estimate assumes the expanded credit would increase donations by 10 percent, bringing total donations to $7.7 million in 2017. Applying the credit rate of 15 percent results in estimated credits generated of $1,150,000. Using the current Fruits and Vegetables Credit data, it is estimated that 85 percent of the credit would be used in the year generated, and the remaining 15 percent would be used over the next 7 years. Because taxpayers must reduce the deduction for qualified donations by the credit amount, an offsetting gain is applied to account for the decrease in reported deductions, resulting in a net $900,000 loss for taxable year 2017.

The tax-year estimates are split between personal income taxpayers and corporate taxpayers, converted to fiscal-year estimates, and then rounded to arrive at the estimates shown in the above table.

APPOINTMENTS

None.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

VOTES

	Date	Yes	No
Concurrence	06/16/16	27	12
Assembly Floor	06/16/16	49	27
Senate Floor	04/14/16	25	11

LEGISLATIVE STAFF CONTACT

Contact	Work
Marybel Batjer, Agency Secretary, GovOps	916-651-9024
Khaim Morton, Legislative Deputy, GovOps	916-651-9100
Selvi Stanislaus, Executive Officer, FTB	916-845-4543
Gail Hall, Legislative Director, FTB	916-845-6333