Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Beall	Analyst:	Jessica Deitchman	Bill Number:	SB 873
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	January 14, 2016
		Attorney:	Bruce Langston	Sponsor	

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.

RECOMMENDATION

No position.

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 LIHC 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.

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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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.

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 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.

THIS BILL

This bill would re-enact and make permanent prior law's 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, 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 LIHC 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 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,
- 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 a LIHC.

A 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 LIHC would be entitled to utilize the purchased LIHC in the same manner the taxpayer that originally received the LIHC could utilize them.

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

A taxpayer could not sell a 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, may 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.

The bill would require the Allocation Committee to enter into an agreement with the FTB to pay any costs incurred by the FTB to administer this bill.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require changes to existing tax forms and instructions and information systems.

TECHNICAL CONSIDERATIONS

To correct grammatical errors, the following amendments are recommended:

On page 3, line 2, after “subject” insert “to”

On page 13, line 32, after “party” insert “or parties”

On page 27, line 3, after “party” insert “or parties”

LEGISLATIVE HISTORY

SB 377 (Beal, 2015/16) substantially similar to this bill, 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 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.”

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 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.

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.

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

FISCAL IMPACT

Reimbursement for providing information, as required in this bill, is normally provided to the FTB through an interagency contract. As the bill moves through the legislative process, costs will be identified and an interagency contact would be negotiated if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of SB 873 As Introduced January 14, 2016 Assumed Enactment After 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 after inflation indexing, 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 to reduce 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 placed into service, 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 reported in the year the credits are purchased, which results in a positive revenue impact for the 2016 and 2017 taxable years.

Combining the accelerated credit usage (relative to current law) and the offsetting increase in capital gains, 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 these amounts would be claimed 98 percent 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 to arrive at the amounts reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some could argue that allowing the LIHC 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 in the state that may need additional incentives to encourage housing development.

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