Franchise Tax Board

ANALYSIS OF ORIGINAL AND AMENDED BILL

Author:	Soto	Analyst:	Jeff Garnier	Bill Number:	SB 2198
Related Bills:		Telephone:	845-5322	Amended Date:	3/16/00 & 4/6/00
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Homeownership Tax Credit Act of 2000

SUMMARY

Under the Bank and Corporation Tax Law (B&CTL), this bill would allow an unspecified "homeownership tax credit" to certain financial corporations for making qualified second mortgage loans. The loans must be made to certain home buyers or to individuals improving their homes under a neighborhood revitalization project. The California Tax Credit Allocation Committee (CTAC) would allocate the credit.

SUMMARY OF AMENDMENT

Prior to the April 6, 2000, amendments, under the Health and Safety Code the bill contained intent language regarding a homeownership tax credit. The April 6, 2000, amendments added the credit language.

EFFECTIVE DATE

This provision would be effective immediately upon enactment and would apply to taxable or income years beginning on or after January 1, 2001.

SPECIFIC FINDING

Existing state law allows a credit for interest income on loans used to finance qualified expenditures for farmworker housing. **Existing state law** also allows taxpayers that make loans to businesses within an Enterprise Zone to deduct net interest.

Existing federal law taxes interest on federal obligations (e.g., bonds issued by the federal government and certain federal agencies) and allows such interest to be included in the income base of a nondiscriminatory state franchise tax. (For this purpose, the tax is nondiscriminatory so long as the tax imposed on the federal interest is not different than tax assessed on any other interest, including interest on state obligations.) **Under existing state law** interest on state obligations (e.g., bonds issued by this state and political subdivisions of this state) and interest on federal obligation are exempt from personal income tax, but are included within the measure of the corporate franchise tax.

This bill would provide that the CTAC allocate a homeownership tax credit in an unspecified amount to qualified lenders that make qualified homeownership tax credit loans.

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The CTAC would allocate the credit, over a credit period of 10 years (computed on a monthly basis), based on bids for the value of the credit submitted by the lenders. Priority would be given to lenders with loans that are prepaid during a calendar year for credit allocations in the succeeding calendar year. The CTAC also would prescribe an applicable percentage that would be applied to the allocated credit amount to arrive at the credit for the year. The applicable percentage would yield over the credit period a present value of 100%. The method used to discount the applicable percentage would be determined under IRC Section 42(b)(2)(C), relating to the low-income housing credit applicable percentage. The homeownership tax credit loan could be disposed of during the credit period and the party acquiring the loan would be allowed the remainder of the credit over the remaining credit period. If a qualified loan were repaid prior to the expiration of the credit period, the amount of the unexpired credit would no longer be available as a credit.

The bill also would appear to require the CTAC to adopt a written “approved allocation plan” certified by an unspecified "Secretary" and include:

- The selection criteria that would be used to award the credit would be based on bids submitted by lenders, and the priority given to specified lenders.
- An assurance that the CTAC would not allocate more than 10% of the credit amount for a calendar year for qualified homeownership tax credit loans that are neighborhood revitalization project loans.
- A procedure the CTAC would follow to monitor for noncompliance with the terms of the law establishing the credit and in notifying the Franchise Tax Board (FTB) of noncompliance.

The CTAC would be required to submit to the FTB, in a manner agreed to by both parties, an annual report. The report would specify:

- The amount of the credit allocated to each qualified lender.
- The principal amount of the aggregate new qualified loans made during the year and the outstanding amount of the loans in the year for each qualified lender.
- The number of qualified loans made by a qualified lender during the year.

The CTAC would be required to prescribe regulations as may be necessary or appropriate to administer this credit.

This bill would allow the FTB, upon finding of non-compliance, to revoke any qualified homeownership tax credit allocated by the CTAC.

A “qualified lender” would meet all of the following requirements:

- Is an insured depository institution, insured credit union, community development financial institution or a nonprofit community development corporation.
- Makes available pre-purchase homeownership counseling for mortgagors.
- Originates a minimum of 100 qualified homeownership tax credit loans during the one–year period beginning with the date the credit was allocated. The aggregate amount of loans made must not be less than the bid made by the lender to the CTAC.

"Qualified homeownership tax credit loans" would mean all of the following:

- ♦ A loan originated and funded by a qualified lender that is secured by a second lien on a residence.
- ♦ The proceeds of the loan are used exclusively to acquire a residence or to substantially improve the residence in connection with a neighborhood revitalization project.
- ♦ The principal amount of the loan is at least 18% of the purchase price of the residence and not more than 20% of the purchase price or $40,000, whichever is less. In the case of a neighborhood revitalization project loan, the appraised value may be used instead of the purchase price, and the $40,000 limit is increased to $55,000. Beginning in 2001, these amounts would be adjusted for inflation based on the housing price index as published by the Federal Housing Finance Board.
- ♦ The loan cannot be amortized over more than a 30-year period. The lender or the CTAC may set the amortization period. The loan may be a balloon payment loan if the following conditions are met:
  - Is for a period of 25 years and no payment is due until the earlier of the end of the period or the date the residence is disposed of. Payment also could be required if the mortgagor (borrower) receives any portion of the equity of the residence while refinancing any loan secured by the residence.
  - Does not prohibit early repayment of the loan.
  - The rate of interest on the balloon payment loan is zero.
  - There are no servicing fees in connection with the balloon payment loan.
- ♦ The proceeds of the loan could not be used to pay settlement or closing costs in excess of 4% of the purchase price of the residence.
- ♦ The rate of interest on the loan does not exceed the greater of 3% or the amount that the prime interest rate, on the date the loan is originated, exceeds 5.5%.
- ♦ The origination fee paid in connection with the loan does not cause the aggregate amount of origination fees paid in connection with any loans securing the property to exceed 2% of the appraised value of the residence, or 1% in the case of neighborhood revitalization project loan.
- ♦ The servicing fees in connection with the loan, when added to the fees of any other loan secured by the residence, may not exceed 63 basis points; 38 basis points in the case of neighborhood revitalization project loan.
- ♦ The mortgagor who is obtaining the loan would have to meet all of the following:
  - Whose family income for the year in which the mortgagor applies for the loan does not exceed 100% of the median gross income for the area where the residence is located, as determined by Section 143(f)(2) of the Internal Revenue Code, relating to income requirements for Mortgage Revenue Bonds.
  - Whose debt-to-income or total debt-to-income ratio after incorporating the homeownership tax credit loan would not exceed guidelines set by the Federal Housing Administration or some lesser ratio determined by the CTAC or the lender.
  - Who attends a pre-purchase homeownership counseling provided by the lender.
  - The residence that secures the loan is or will be owner-occupied and a single family residence and was purchased by a mortgagor with a down payment not less than the lesser of 2% of the purchase price or $2,500.

A “neighborhood revitalization project loan” would mean a loan secured by a second lien on a residence and used to substantially improve the residence in connection with a neighborhood revitalization project.

A “neighborhood revitalization project” would mean a project of sufficient size to alleviate physical deterioration and simulate investment. A neighborhood revitalization project area would have to be designated by a local government in an ordinance or other document. Unless the local government’s jurisdiction covers a population of not more than 25,000, the neighborhood revitalization project area could not be the entire local jurisdiction.

This bill would require, under certain circumstances, that if a borrower with family income of 115% or more of the area median gross income disposes of the residence to which a homeownership tax credit applies, the taxpayer’s tax due under the B&CTL shall be increased by 50% of the gain on the disposition of the residence. The qualified lender would be required, at the time of settlement, to provide the mortgagor with a written statement informing the mortgagor of the potential recapture. This rule would not apply to a borrower who meets at least one of the following:

- The disposition was made more than 10 years after the qualified homeownership tax credit loan was made.
- The disposition is by reason of death.
- The purchaser of the residence assumes the homeownership tax credit loan.

This bill also would provide that no portion of the unused business credit for any taxable year, which is attributable to the credit determined under Section 45D, may be carried back to a taxable year ending before the date of the enactment of this bill.

Policy Considerations

Federal law prohibits discriminatory state taxation of interest on federal obligations. This bill provides a credit to banks and financial corporations for interest forgone on loans relating to homeownership loans. This could be interpreted to subject interest on federal obligations to a discriminatory state franchise tax in violation of federal law.

It is possible this bill would allow the credit for purchases of homes located outside of this state.

This bill would allow the taxpayer to carry back the credit to an income year prior to the year the credit was earned. No other credit or deduction under California law is allowed to be carried back.

The tax credit does not contain a sunset date. Recently enacted credits contain sunset dates and generally are provided to allow periodic review by the Legislature.

Implementation Considerations

The major implementation considerations are as follows:

- It is unclear if the CTAC would set the applicable percentage at the beginning of the credit period or would set a new applicable percentage every year.
- It is unclear if the maximum credit the CTAC can allocate every year is for a single taxpayer, the aggregate amount for all taxpayers, or both.
- The terms "taxpayer," "Secretary," "reasonable," "residence," and "Section 45D" are not clearly defined. The phrases "approved allocation plan" and "balloon payment loan" are defined but not used.
- It is unclear if any loan would qualify as a neighborhood revitalization project loan because the terms "neighborhood loan revitalization project loan" and/or "appraised value" do not appear in all instances that they are needed.
- The bill would impose a tax under the B&CTL on a taxpayer if an individual (a "Personal Income Tax Law" taxpayer) disposed of the residence to which a homeownership tax credit applies within 10 years after the loan was made . The tax imposed would be equal to 50% of the gain on the disposal of the residence.
- It appears a non-qualified lender could purchase the loan and be entitled to claim the credit for the remainder of the credit period.

Department staff is available to work with the author as the bill proceeds through the Legislature to resolve the concerns.

Technical Considerations

There are numerous technical considerations, including cross referencing errors, that would best be corrected after the implementation considerations are addressed.

FISCAL IMPACT

Departmental Costs

Once the implementation considerations are resolved, this bill should not significantly impact the department's cost.

Tax Revenue Estimate

The revenue estimate is unknown and cannot be determined until the annual amount of credit that can be allocated by the CTAC is stated.

BOARD POSITION

Pending.