Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Chiu	Analyst:	Jessica Deitchman	Bill Number:	AB 35
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Date:	December 1, 2014
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Low Income Housing Credit

SUMMARY

This bill would provide, under the Personal Income Tax Law and Corporation Tax Law, a credit for investment in very low-income and extremely low-income housing in California.

This analysis only addresses the provisions of the bill that impact the department’s programs and operations. This analysis does not discuss the provisions administered by the California Tax Credit Allocation Committee.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to encourage investment in older low-income housing in the state by providing a tax credit program that targets this type of investment.

EFFECTIVE/OPERATIVE DATE

As a tax levy, the bill would be effective immediately upon enactment and specifically operative on or after January 1, 2015.

FEDERAL/STATE LAW

Current federal tax law allows a Low Income Housing Credit (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 Low-Income Housing Tax Credit Programs.

[1] Voting members of this committee are the state controller, the state treasurer and the director of finance.

Board Position:			Executive Officer	Date
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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:

- 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.

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.

THIS BILL

This bill would establish, for taxable years beginning on or after January 1, 2015, a “very low-income” and “extremely low-income” housing credit. The amount of credit would be authorized and allocated by the Allocation Committee. The credit would be in accordance with Section 42 of the Internal Revenue Code except that the state LIHC is limited to projects located in California and must be allocated and authorized by the Allocation Committee. There would be no requirement that the project previously received federal or state tax credits when originally constructed.

The aggregate amount that may be allocated annually by the Allocation Committee would be an amount equal to the sum of all of the following:

- $40 million,
- The unused allocation credit amount, if any, for the preceding fiscal year, and
- The amount of housing credits returned in the calendar year.

The Allocation Committee would certify the amount of tax credit 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 FTB.

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

A deduction otherwise allowed for any amount paid or incurred by the taxpayer upon which the credit is based would be reduced by the amount of the credit allowed by this bill.

The credit would be allowed only for credits claimed on a timely filed original tax return.

The Allocation Committee and the FTB may adopt regulations, rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this bill.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would occur during the department's normal annual update.

TECHNICAL CONSIDERATIONS

The language specifying that the Administrative Procedures Act would apply is unnecessary because existing law provides this general law. On page 5, strikeout lines 16-19, inclusive, and on page 8, strikeout lines 18-21, inclusive.

LEGISLATIVE HISTORY

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. This bill 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. This bill 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 be 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

Review of *Illinois, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found no comparable tax credits to the credit being proposed in this bill. These states selected and reviewed due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 35 As Introduced December 1, 2014 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $21	- $23	- $24

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

Revenue Discussion

Based upon the popularity of the current LIHC, it is assumed that the $40 million credit allocation threshold would be reached each year. It is assumed that five percent, or $2 million, of the allocation would ultimately be returned to the Allocation Committee due to unforeseen project issues. Under the existing LIHC program 60 percent of the credit is used in the year generated and 98 percent is claimed by corporations. This same pattern is used in this estimate. Based upon the department's carryover credit data, it is assumed that the remaining 40 percent carryover credit would be used over the next 10 years. In addition, taxpayers that claim the credit could no longer deduct qualifying expenses, resulting in an offsetting gain of $7 million.

After applying the offsetting gain it is estimated that the average annual revenue loss would be $24 million per year. The tax year estimates are converted to fiscal year estimates and reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some could argue that this bill would increase the development of additional low-income housing by incentivizing rehabilitation of this type of 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.

POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

This bill would allow taxpayers in certain circumstances, to claim multiple tax credits benefits for the same item of expense.

Certain business-related tax credits (e.g., low-income housing credit and research credit) are limited to the tax attributable to the taxpayer's passive activities. These credits are known as passive activity credits. The purpose of this limitation is to prevent taxpayers from using a credit from a passive activity to offset tax attributable to other income. Since this credit is not included in the list of passive activity credits, taxpayers who generate this credit from a passive activity would be able to use the credit to offset tax attributable to any income.

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