



Analysis of Amended Bill

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Sponsor:

Bill Number: AB 3072

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Amended: March 22, 2018, and
April 17, 2018

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Related Bills: See Legislative
History

Subject: Low-Income Housing Credit/Farmworker Housing Credit

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), modify the Low-Income Housing Credit (LIHC).

This bill would also modify provisions of the Insurance Tax Law. This analysis only addresses the provisions of the bill that impact the department's programs and operations.

Recommendation – No position.

Summary of Amendments

The March 22, 2018, amendments removed provisions of the Government Code relating to housing, and added provisions modifying the LIHC as discussed in this analysis.

The April 17, 2018, amendments further modified the LIHC and eliminated the limit on the passive activity loss credit allowed with respect to the LIHC.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for the bill is to increase development of low-income housing in California by increasing the credit amounts available for farmworker housing projects.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment. The provisions affecting the computation of tax due to changes in passive activity losses and credits would be operative for taxable years beginning on and after January 1, 2018.

The provisions increasing amounts available for allocation by the California Tax Credit Allocation Committee (Allocation Committee) would be specifically operative for allocations made during or after calendar year 2019. The provisions modifying definitions and the LIHC's applicable percentage would be operative as of January 1, 2018.

Federal/State Law

Low-Income Housing Credit

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 Allocation Committee¹ allocates and administers the federal and state LIHC Programs.

Current state tax law generally conforms to federal law (Section 42 of the Internal Revenue Code (IRC)) with respect to the LIHC, except that the state LIHC is claimed over four taxable years, 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, and the Allocation Committee must have authorized a federal credit to the taxpayer or the taxpayer must qualify for the federal credit.

Allocation to partners is 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.

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

The Allocation Committee certifies the amount of LIHC 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).

The Allocation Committee is required to enter into an agreement with the FTB to pay any costs incurred by the FTB to administer this credit.

An LIHC can be sold to more than one unrelated party, but cannot 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.

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

Aggregate Credit Amount

The Allocation Committee is authorized to annually allocate LIHCs in the amount equal to the sum of the following:

- 1) \$70 million for the 2001 calendar year, and beginning in 2002, increased by any percentage increase in the Consumer Price Index (CPI) for the preceding calendar year,
- 2) The unused housing credit ceiling, if any, for the preceding calendar years,
- 3) The amount of housing credit ceiling returned in the calendar year,
- 4) \$500,000 per calendar year allocated to farmworker housing, and
- 5) Certain unallocated or returned credits allowed prior to 2009.

Passive Activity Losses

Federal and state laws provide that passive activity losses are generally deductible only from passive activity income. Passive activity includes any rental activity, whether or not the taxpayer materially participates. Federal law provides an exception, in the case of a natural person, to losses from rental real estate activities that do not exceed \$25,000. California specifically modifies this provision to allow passive activity losses from rental real estate relating to low-income housing to a maximum of \$75,000.²

This Bill

This bill would, for purposes of the LIHC, modify the definitions of:

- “Taxpayer” to include members of a limited liability company.
- “Housing sponsor” to include limited liability companies.
- “Extremely low income households” and “Very low income households” to have the same meanings as in Section 50053 of the Health and Safety Code.

This bill would recast the LIHC applicable percentages as follows:

- For a new building that is not federally subsidized, the applicable percentage for years 1 through 3 would be the amount determined pursuant to IRC section 42(b)(1) and for year 4 would be the difference between 30 percent and the sum of the amounts for years 1 through 3.
- For a new building that is federally subsidized, 15 percent for the first three years and 5 percent for the fourth year.
- For an existing building that is federally subsidized, the applicable percentage for years 1 through 3 would be the amount prescribed by the Secretary of the Treasury for new buildings that are federally subsidized for the taxable year, and for year 4 would be the difference between 13 percent and the sum of the amounts for years 1 through 3.

² Revenue and Taxation Code sections 17561(d) and 24692(e).

- For any qualified low-income building that meets all of the following criteria, the applicable percentage would mean 30 percent for each of the first three years and 5 percent for the fourth year. Additionally, a qualified low-income building that received this increased allocation would be ineligible for an allocation under the prior bulleted item.
 - Is at least 15 years old.
 - Is serving households of very low income or extremely low income whose maximum household income is not more than 45 percent of the area median gross income, as specified.
 - Would have insufficient credits under the second and third bulleted items above to complete substantial rehabilitation due to a low appraised value.
 - Will complete the substantial rehabilitation in connection with this increased credit allocation regime.

Beginning for allocations made by the Allocation Committee during calendar year 2019, this bill would:

- Increase the LIHC allocation amount by an additional \$300 million, subject to indexing for inflation as specified.
- Increase the annual amount available for allocation to farmworker housing projects from \$500,000 to \$25 million. Unallocated amounts for a calendar year would be added to the total LIHC allocation amount available for the following calendar year.

This bill would, under the PITL and CTL, eliminate the limitation on the LIHC credit applicable to the \$75,000 passive activity loss from rental real estate activities otherwise allowed.

Implementation Considerations

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill would eliminate the limitation on the LIHC credit applicable to the \$75,000 passive activity losses from rental real estate activities otherwise allowed while leaving the phase-out provisions applicable to such passive activities intact. If this is contrary to the author's intent, this bill should be amended.

Technical Considerations

The references to limited liability company in the PITL and CTL are unnecessary. The following six amendments are recommended:

On page 17, line 18, strike "members in the case of a limited liability company"

On page 17, lines 22-23, after "partnership" strike "the limited liability company in the case of a limited liability company"

On page 33, line 14, after “partnership,” strike “members in the case of a limited liability company”

On page 33, lines 18-19, after “partnership,” strike “the limited liability company in the case of a limited liability company”

Legislative History

AB 2922 (Gipson, 2017/2018) would create an allocated tax credit for amounts paid or incurred by a taxpayer to a qualified developer of low-income housing. AB 2922 is currently referred to the Assembly Appropriations Committee.

AB 2999 (Bonta, 2017/2018) would allow a tax credit for certain costs incurred by an employer related to the construction of affordable housing, or investment in an employer-assisted housing program. AB 2999 is currently referred to the Assembly Appropriations Committee.

SB 1253 (Jackson, 2017/2018) would increase the annual allocation amount, and allow a project located in the “qualified opportunity zone,” as a qualifying low-income housing project. SB 1253 is currently referred to the Senate Committee on Appropriations.

AB 71 (Garcia, et al., 2017/2018) would have modified the allocation of the LIHC relating to the types of housing and methods that qualified, and would have disallowed the deduction of mortgage interest paid on a second home. AB 71 failed to pass by the constitutional deadline.

AB 571 (Garcia, Chapter 372, Statutes of 2017) modified: 1) the definition of farmworker housing; and 2) the applicable percentage used by the Allocation Committee for purposes of allocating and determining the LIHC for federally subsidized farmworker housing.

AB 35 (Chiu and Atkins, 2015/2016) would have modified the LIHC to increase the amount of credit that may be allocated. AB 35 and eight other bills were vetoed by Governor Brown on October 15, 2015, because he could not support additional tax credits that were not considered comprehensively as part of the budget deliberations.

AB 2817 (Chiu, 2015/2016) would have increased the LIHC allocation amount by an additional \$300 million and would have modified the farmworker housing projects allocation amount. AB 2817 failed to pass by the constitutional deadline.

AB 952 (Atkins, Chapter 771, Statutes of 2013) made modifications to: 1) allow the Allocation Committee to award LIHC to developments in qualified census tracts or difficult areas; 2) allow the Allocation Committee to replace the federal LIHC with a state LIHC up to 30 percent of a project’s eligible basis, if the federal LIHC is reduced in an equivalent amount.

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, Massachusetts, Michigan, and New York offer a state LIHC similar to the credit offered in California. The *Florida* corporate tax credit is 9 percent of the eligible basis of any designated project for each year of the credit period. The *Massachusetts* credit was capped at \$20,000,000 per calendar year and the *New York* credit is not allocated on a calendar-year basis.

Illinois 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.

Minnesota lacks a state LIHC.

Fiscal Impact

The department's costs to implement the provisions of this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of AB 3072 as Amended April 17, 2018
For Taxable Years Beginning On or After January 1, 2018
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	+ \$0.15
2019-2020	- \$0.35
2020-2021	- \$32

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual. 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 assumed that the maximum credit allocation threshold would be reached each year. This bill authorizes an additional \$300 million in LIHC allocations beginning for allocations made during calendar year 2019. It is assumed that five percent, or \$15 million, of the allocation would ultimately be returned to the Allocation Committee due to unforeseen project issues. According to Farmworker Housing allocation data from the Allocation Committee, \$3.4 million in farmworker state tax credits were awarded in 2017, leaving \$2.7 million awaiting allocation in 2018. Because prior allocations of the farmworker housing credit were infrequent, the \$25 million credit allocation is modeled as a

one-year allocation lag, this lag is applied to each year. For example, the \$25 million would be set aside in tax year 2019, and then added back in tax year 2020.

Based on total current LIHC awards and usage, it is estimated that 75 percent, or \$195 million, of the annual credits would be used to offset income and franchise taxes and the remainder would be used against insurance taxes, which is not included in the table above. Based on current LIHC usage, it is assumed that 70 percent, or \$135 million, of the credit would be used over the four-year credit period and the remaining 30 percent would be carried forward to future years. It is further assumed that 25 percent of the carry forward would be sold at 80 percent of its face value causing the seller to recognize capital gains in the year of the sale. It is assumed these amounts would be used over the four-year credit period.

Allocated credits cannot be used until after the building has been put into service. As a result, credit usage would not begin until 2021. Current usage indicates that 98 percent would be claimed by corporations and the remaining 2 percent would be claimed by personal income taxpayers.

Because this provision removes the limitation for rental real estate offsets, this estimate assumes taxpayers would offset income by additional passive activity losses attributed to rental real estate activities. Because the FTB has limited data on total rental losses incurred annually, this results in an assumed additional revenue loss of \$20 million in the 2021 taxable year. The incentive for taxpayers with large losses to participate in qualified low-income housing projects is not accounted for in the estimate.

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

The combined revenue impact from the sale and credit usage results in a revenue gain of \$150,000 in the first year and a revenue loss of approximately \$32 million in fiscal year 2020-2021 increasing to \$220 million in fiscal year 2025-2026.

Since there is no sunset date, over time the net revenue loss from the additional LIHC and removing the passive loss limitation attributed to rental real estate activity could exceed the \$300 million allocation amount, but this depends on the inflation rate, changes in the economy, and future credit usage.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some could argue that increasing the amount that could be allocated for the LIHC would expand the inventory of affordable housing in the state.

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

The changes to the LIHC that this bill would make lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a tax benefit by the Legislature.

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