

**SUMMARY ANALYSIS OF AMENDED BILL**

Author: Chiu, et al. Analyst: Jessica Deitchman Bill Number: AB 71  
 Related Bills: See Prior Telephone: 845-6310 Amended Date May 18, 2017  
Analysis Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Low-Income Housing Credit/Farmworker Housing and Disallow Second Home Mortgage Interest Deduction

**SUMMARY**

This bill would do the following:

**Provision 1:** Modify the existing Low-Income Housing Credit (LIHC) under the Insurance Tax Law, the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

**Provision 2:** Disallow the deduction of mortgage interest paid on a second home under the PITL.

This analysis only addresses the provisions of the bill that impact the department's programs and operations.

**RECOMMENDATION – NO POSITION****SUMMARY OF AMENDMENTS**

The May 18, 2017, amendments made a number of technical changes including accepting the technical considerations provided in the department's analysis of the bill as amended March 2, 2017. As a result of the amendments, the department's technical considerations related to the LIHC were resolved and two new technical considerations were created.

Except for the "Technical Considerations" section relating to the LIHC and the "Economic Impact" section relating to the elimination of the mortgage interest deduction for second homes that has been updated to reflect the most recent data available, the remainder of the department's analysis of the bill as amended March 2, 2017, still applies. The "This Bill," "Fiscal Impact," and unresolved "Technical Considerations," and "Policy Concerns" sections for each provision are listed below for convenience.

**ECONOMIC IMPACT – SUMMARY REVENUE TABLE (\$ in Millions)**

Fiscal Year	2017-18	2018-19	2019-20
<b>Provision 1:</b> Modify the LIHC	+ \$.2	+ \$.2	- \$19
<b>Provision 2:</b> Eliminate the Mortgage Interest Deduction for a Second Home	+ \$360	+ \$240	+ \$260
<b><u>\$ In Millions Total</u></b>	<b><u>+ \$360.2</u></b>	<b><u>+ \$240.2</u></b>	<b><u>+ \$241</u></b>

## **Provision 1: Modify the LIHC**

### **THIS PROVISION**

This provision would modify the allocation of the LIHC relating to the types of housing that qualifies and how it qualifies, administered by the Allocation Committee.

Additionally, this provision would, for allocations made during calendar year 2018 and for each calendar year thereafter:

- Increase the annual allocation amount by \$300 million, subject to indexing for inflation, as specified.
- Preclude housing sponsors receiving an allocation under paragraph (1) of subdivision (c)<sup>1</sup> from receiving an allocation from the increased amount.
- Specify that \$25 million of the additional \$300 million annual allocation would be allocated for projects to provide farmworker housing, as defined in subdivision (h) of Section 50199.7 of the Health and Safety Code.
- Specify that the amount of any unallocated or returned credits for a calendar year would be added to the aggregate amounts of credits that could be allocated, as specified.

### **TECHNICAL CONSIDERATIONS**

To correct nomenclature errors, the following six amendments are recommended:

On page 6, line 33, strike “(i)” and insert “(A)”

On page 6, line 36, strike “(ii)” and insert “(B)”

On page 21, line 17 strike “(i)” and insert “(A)”

On page 21, line 20, strike “(ii)” and insert “(B)”

On page 36, line 22 strike “(i)” and insert “(A)”

On page 36, line 25, strike “(ii)” and insert “(B)”

To correct a grammatical error, the following amendment is recommended:

On page 9 line 19, after “allocation year,” strike “Code”

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<sup>1</sup> Relating to any qualified low-income building that is a new building as defined in Section 42 of the Internal Revenue Code (IRC).

**FISCAL IMPACT**

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

**ECONOMIC IMPACT**

This provision would result in the following revenue impact:

Estimated Revenue Impact of AB 71 Provision 1: Modify the LIHC As Amended March 2, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
+ \$0.2	+ \$0.2	- \$19

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. The estimated revenue loss would continue to increase reaching \$170 million in fiscal year 2023-24.

Using LIHC allocation data from the Allocation Committee, it is assumed that the maximum credit allocation threshold would be reached each year. This bill would authorize an additional \$300 million in LIHC allocations beginning for allocations made during calendar year 2018. 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 information provided by the Allocation Committee, the farmworkers housing credit is largely under allocated and there is over \$5 million awaiting allocation. Due to the infrequent allocation of the farmworkers housing credit, the \$25 million credit allocation was modeled as a one year allocation lag applied to each year. For example, the \$25 million would be set aside in tax year 2018, and then added back in tax year 2019. Based on total current LIHC awards and usage, it is estimated that 75 percent of the remaining annual credits would be used to offset income and franchise taxes and the remainder would be used against insurance taxes. Based on current LIHC usage, it is assumed that 70 percent 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. Because allocated credits cannot be used until the building has been put into service, credit usage would not begin until 2020. 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 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 in the first two years and a revenue loss of approximately \$19 million in fiscal year 2019-20, increasing to \$170 million in fiscal year 2023-24.

## **Provision 2: Eliminate the Mortgage Interest Deduction for a Second Home**

### **THIS PROVISION**

This provision would disallow a deduction of mortgage interest paid on a second home as defined in the IRC.<sup>2</sup>

### **FISCAL IMPACT**

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

### **ECONOMIC IMPACT**

This provision in the bill would result in the following revenue gain:

Estimated Revenue Impact of AB 71 Provision 2: Eliminate the Mortgage Interest Deduction for a Second Home As Amended May 18, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
+ \$320	+ \$210	+ \$220

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

The bill as amended May 18, 2017, does not affect the revenue impact of this bill. However, the estimate was revised based upon updated tax return data.

Based upon FTB 2015 tax return data, it was determined that taxpayers claimed \$53 billion in mortgage interest deductions on their tax year 2015 taxable returns. This figure was grown to reflect changes in the economy over time. According to articles published by Fannie Mae, approximately 5 percent of total home mortgage originations are for second home mortgages. For purposes of this estimate, it is assumed that the existing mix of primary home mortgages

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<sup>2</sup> IRC sections 163(h)(4)(A)(i)(II) and 163(h)(4)(A)(ii)(II).

versus second home mortgages would be similar. It is estimated the average tax rate for these taxpayers is about eight percent, resulting in the estimated revenue gain of approximately \$200 million in tax year 2017 for eliminating the mortgage interest deduction on a second home.

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

### **SUPPORT/OPPOSITION<sup>3</sup>**

Support: Alameda County Board of Supervisors, American Planning Association, California Chapter Association of Regional Center Agencies, California Alternative Payment Program Association, California Apartment Association, California Catholic Conference, California Collaborative for Long Term Services, California Coalition for Youth, California League of Conservation Voters, California Rural League Assistance Foundation, California Tax Reform Association, City and County of San Francisco, City of Santa Monica, Council of Infill Builders, Housing California, Metropolitan Transportation Commission, National Association of Social Workers-California Chapter, Planning and Conservation League, Public Advocates, SF Council of Community Housing Organizations, State Building and Construction Trades Council, Tenants Together, Western Center on Law & Poverty.

Opposition: Amador County Association of Realtors, Arcadia Association of Realtors, Bay East Association of Realtors, Beverly Hills/Greater Los Angeles Association of Realtors, Burbank Association of Realtors, Calaveras County Association of Realtors, California Association of Realtors, California Credit Union League, Central Valley Associations of Realtors, Citrus Valley Association of Realtors, Coastal Mendocino Association of Realtors, Conejo Simi Association of Association, Contra Costa Association of Realtors, El Dorado County Association of Realtors, Fresno Association of Realtors, Gilroy Chamber of Commerce, Goleta Chamber of Commerce, Greater Antelope Valley Association of Realtors, High Desert Association of Realtors, Howard Jarvis Taxpayers Association, Humboldt Association of Realtors, Inglewood Board of Realtors, Inland Valleys Association of Realtors, Inland Gateway Association of Realtors, Kings County Board of Realtors, Laguna Board of Realtors, Lake County Association of Realtors, Lodi Association of Realtors, Mammoth Lakes Board of Realtors, Marin Association of Realtors, Mariposa County Board of Realtors, Merced County Association of Realtors, Monterey County Association of Realtors, Nevada County Association of Realtors, Newport Beach Association of Realtors, North Bay Association of Realtors, North San Diego County Association of Realtors, Oakland/Berkeley Association of Realtors, Orange County Association of Realtors, Oroville Association of Realtors, Palm Springs Regional Associations of Realtors, Placer County Association of Realtors, Palos Verdes Peninsula Association of Realtors, Pasadena-Foothills Association of Realtors, Pismo Coast Association of Realtors, Plumas Association of Realtors, Sacramento Association of Realtors, San Mateo County Association of Realtors, Santa Barbara Association of Realtors, Santa Clara County Association of Realtors, Shasta Association of Realtors, Silicon Valley Association of Realtors,

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<sup>3</sup> As provided in the Assembly Revenue and Taxation Committee Analysis dated May 12, 2017.

South Bay Association of Realtors, South Tahoe Association of Realtors, Southland Regional Association of Realtors, Southwest Riverside County Association of Realtors, Sutter-Yuba Association of Realtors, Tahoe Sierra Board of Realtors, Tehachapi Area Association of Realtors, Tuolumne County Association of Realtors, Ventura County Coastal Association of Realtors, and two private individuals.

## **POLICY CONCERNS**

Provision 2 of this bill would create differences between federal and California tax law regarding the deductibility of home mortgage interest, thereby increasing the complexity of California tax return preparation.

## **LEGISLATIVE STAFF CONTACT**

Jessica Deitchman  
Legislative Analyst, FTB  
(916) 845-6310  
[jessica.deitchman@ftb.ca.gov](mailto:jessica.deitchman@ftb.ca.gov)

Jame Eiserman  
Revenue Manager, FTB  
(916) 845-7484  
[jame.eiserman@ftb.ca.gov](mailto:jame.eiserman@ftb.ca.gov)

Diane Deatherage  
Legislative Director, FTB  
(916) 845-6333  
[diane.deatherage@ftb.ca.gov](mailto:diane.deatherage@ftb.ca.gov)