STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

Author: Gabriel, et al.	Sponsor:	Bill Number: AB 791
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Subject: Low-Income Housing Credit/Qualified Opportunity Zone

Summary:

This bill would do the following:

Provision No. 1:

This provision would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), expand the Low-Income Housing Credit (LIHC) to allow beneficial tax treatment for the sale of property to a qualified developer in a qualified opportunity zone (QOZ).

Provision No. 2:

This provision would, under the PITL and the CTL, expand the LIHC for investment in QOZs.

Recommendation – No position.

Summary of Amendments

The March 26, 2019, amendments removed intent language and added provisions, which would provide for a LIHC related to the sale of property in a QOZ to a qualified developer, and would authorize additional LIHC for qualified low-income housing projects located in QOZs.

The April 22, 2019, amendments added coauthors, added and modified defined terms, added reporting requirements, a sunset date, and modified provisions administered by the California Tax Credit Allocation Committee (Allocation Committee).

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

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

Reason for the Bill

The reason for the bill is to increase development of low-income housing in California by expanding the LIHC.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

Economic Impact – Summary Revenue Table ($ in Millions)

Fiscal Year	2019-2020	2020-2021	2021-2022
Provision 1: Expand the LIHC for Sale of Property	-$1.2	-$9.7	-$23.0
Provision 2: Expand the LIHC for Investment	-$0.0	-$0.0	-$16.0
Total $ in Millions	-$1.2	-$9.7	-$39.0

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

Current state tax law generally conforms to federal law (Internal Revenue Code (IRC) section 42)) with respect to the LIHC, except that the state LIHC is claimed over four taxable years (rather than 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 (rather than 15 years for federal), and the taxpayer must have either received a federal credit from the Allocation

Committee or qualify for the federal credit. The LIHC is allocated in amounts equal to the sum of all the following:

- $100 million.
- The unused housing credit ceiling, if any, for the preceding calendar years.
- The amount of housing credit ceiling returned in the calendar year.
- $500,000 per calendar year for projects to provide farmworker housing.

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.

The Allocation Committee, when considering an allocation, must ensure that the taxpayer prioritizes, to the maximum extent allowed by law, making affordable units available to low-income residents of a QOZ in which the property is located.

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. No subsequent sales are allowed.

Federal law, effective December 22, 2017, designates certain population census tracts as “Qualified Opportunity Zones.”

Currently, California does not conform to this provision.

Provision No. 1: Expand the LIHC for Sale of Property

This Provision

This provision would, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, under the PITL and CTL, allow the transfer of a tax credit to a taxpayer pursuant to the sale of eligible property located in a QOZ to a qualified developer that has received a credit reservation from the Allocation Committee. The bill would limit the aggregate amount of the credit that may be allocated by the Allocation Committee to $100 million and would include all recaptured credit amounts.

The qualified developer would apply for a credit reservation in an amount equal to the sum of:

a) Fifty percent of the estimated federal capital gains taxes to be paid by the taxpayer based on the gains recognized for the sale of property to the qualified developer.
b) Fifty percent of the estimated state income taxes paid by the taxpayer derived from the capital gains recognized for the sale of the property to the qualified developer.

The amount of credit transferred to the seller from a qualified developer is established at the close of escrow and included in the closing or transaction documents.

Fifty percent of the transferred credit amount would be allocated to the taxpayer in the taxable year in which the sale of property is made to the qualified developer. The remaining 50 percent of the transferred credit amount would be allocated to the taxpayer in the taxable year following the sale of property. The taxpayer must demonstrate to the Allocation Committee that the actual amount of federal and state income taxes paid that were derived from such sale of property is not less than the estimated taxes, or the credit amount allocated to the taxpayer must be reduced.

This bill would define a "qualified developer" as an eligible nonprofit corporation, a limited partnership in which the managing general partner is an eligible nonprofit corporation, or a limited liability company in which the managing member is an eligible nonprofit corporation, preserving or acquiring affordable housing located in a QOZ in the state that enters into a regulatory agreement with the committee that requires all vacant housing meet all of the following requirements:

a) Be rented to low-income households, so that at least 75 percent of the households earn an average income that does not exceed 80 percent of the area median income, and no household earns more than 120 percent of area median income.
b) Be rented to low-income households at affordable rates, as determined based on the maximum rents established by the Allocation Committee, for a minimum of 55 years.

In addition, the qualified developer prioritizes making affordable units available to low-income residents of a QOZ in which the property is located to the maximum extent allowed by law.

The bill defines "eligible nonprofit corporation" as a California nonprofit corporation whose primary activity is the development and preservation of affordable rental housing, as determined by the Allocation Committee.

The credit reservation and allocation processes would be administered by the Allocation Committee. The Allocation Committee would be required in consultation with the FTB to establish a procedure to confirm the credit amount allocated to a taxpayer.

The credits shall be allocated on a first-come-first-served basis.

Implementation Considerations

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

Because this provision fails to specify otherwise, it is possible that one taxpayer with multiple or one very large qualified property sale could receive the entire benefit of the credit this bill would allow. If this is contrary to the author's intent, this bill should be amended.

Legislative History

AB 71 (Garcia, et al., 2017/2018), would have among other things, modified the allocation of the LIHC administered by the allocation committee. AB 71 failed to pass by the constitutional deadline.

AB 201 (Steinorth, 2017/2018) would have allowed a credit on the sale of a qualified vacant lot and an additional credit if construction on the vacant lot begins within five years. AB 201 failed to pass by the constitutional deadline.

AB 1670 (Gomez, 2017/2018) would have allowed a credit equal to 50 percent of the amount paid or incurred by a taxpayer to a qualified developer for the development of a qualified project. AB 1670 failed to pass by the constitutional deadline.

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 is capped at $20,000,000 per calendar year, and the *New York* credit is allowed without a calendar-year basis limit.

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 LIHC is allocated and managed by the Allocation Committee; therefore, these changes would not significantly impact the department.

Economic Impact

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 791 as Amended April 22, 2019
Assumed Enactment after June 30, 2019

($ in Millions)

Fiscal Year	Revenue
2019-2020	-$1.2
2020-2021	-$9.7
2021-2022	-$23

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.

Revenue Discussion

For taxable year 2020, it is assumed that the maximum aggregate credit amount of $100 million would be reserved. Due to the timing of the enactment and the completion of sales it is assumed that 10 percent, or $10 million in credits, would be allocated in 2020, and the remaining $90 million would be allocated over the subsequent two years. Per the provisions of the bill, 50 percent of the allocation, or $5 million, would be transferred to taxpayers in 2020 and the remaining $5 million would be transferred in 2021. Additionally, this estimate assumes an annual 14 percent credit recapture for projects that never complete or when the estimated federal and state income taxes paid on the capital gains of the sale were higher than actual taxes paid. This recapture, approximately $700,000 for 2020, is added to the allocation amount available in the following tax year. The net revenue loss for tax year 2020 is $4.3 million. It is estimated that the revenue loss would peak at $40 million in tax year 2022. The tax year estimates are converted to fiscal year revenue estimates, rounded and reflected in the above table.

Legal Impact

This provision would restrict the tax credit to activities in California QOZs. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to improperly favor in-state activity over out-of-state activity. On August 28, 2012, (*Cutler* v. *Franchise Tax Board*), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Stock (QSBS) statutes were unconstitutional. Specifically, the Court of Appeal held that the QSBS statutes were found to unconstitutionally deny the taxpayer the benefit due to expansion of its activities outside of California.

Policy Concern

This provision would allow the credit to be claimed based on the year in which a property is sold to a qualified developer with respect to a qualified project rather than in the year the qualified project is placed in service and ready for occupancy. As a result, credits would be allowed regardless of whether or when the qualified property is completed and occupied. To alleviate the risk of abandonment, the credit could be allowed upon certification of occupancy.

Provision No. 2: Expand the LIHC for Investment

This Provision

This provision would, under the PITL and CTL, authorize an additional $200 million in LIHC allocations by the Allocation Committee. The additional amount would be available for allocation, without regard to calendar year, for the period beginning January 1, 2020, and before January 1, 2025, or until exhausted, whichever occurs first. Eligibility for the increased LIHC would be limited to low-income housing projects located in a QOZ as defined in IRC section 1400Z-1. A qualified project, in addition to other requirements of this section, must be a new building and no unit can be made available to a household with income greater than 120 percent of the area median income. The aggregate amount of LIHC that may be allocated under current law would not include the $200 million in additional credit available for allocation under the opportunity zone provision.

Implementation Considerations

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

Under Revenue and Taxation Code (RTC) section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the credit's effectiveness.

This bill should be amended to satisfy the RTC section 41 requirements.

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 failed to pass by the constitutional deadline.

AB 3072 (Chiu, 2017/2018) would increase the LIHC allocation by $300 million and allocate to farmworker housing projects $25 million per year of that amount. AB 3072 failed to pass by the constitutional deadline.

SB 1253 (Jackson, 2017/2018) would have expanded the LIHC. SB 1253 failed to pass by the constitutional deadline.

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 was 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 LIHC is allocated and managed by the Allocation Committee; therefore, these changes would not significantly impact the department.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 791 as Amended April 22, 2019
Assumed Enactment after June 30, 2019

($ in Millions)

Fiscal Year	Revenue
2019-2020	-$0.0
2020-2021	-$0.0
2021-2022	-$16.0

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.

Revenue Discussion

Using LIHC allocation data from the Allocation Committee, it is assumed that the maximum credit of $200 million would be fully allocated in the 2020 taxable year. It is assumed that five percent, or $10 million of allocations, would ultimately be returned to the Allocation Committee due to unforeseen project issues and would be allocated in the subsequent year.

Based on current LIHC usage, it is assumed that 70 percent, or $133 million would be used over the four year credit period, and the remaining 30 percent would be carried forward to future years. Allocated credits cannot be used until after the building has been put into service. As a result, credit usage would not begin until 2022. Current usage indicates that 98 percent would be claimed by corporations and the remaining 2 percent would be claimed by personal income taxpayers. This would result in an estimated revenue loss of $33 million in the 2022 taxable year.

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

Legal Impact

This provision would restrict the tax credit to activities in California QOZs. This provision could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to improperly favor in-state activity over out-of-state activity. On August 28, 2012, (*Cutler* v. *Franchise Tax Board*), the Court of Appeal issued a unanimous opinion holding that California's QSBS statutes were unconstitutional. Specifically, the Court of Appeal held that the QSBS statutes were found to unconstitutionally deny the taxpayer the benefit due to expansion of its activities outside of California.

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