STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

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Subject: Exclusions/Mobilehome Park Sales

Summary

This bill, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), would provide a gross income exclusion for the gain on the sale of a qualified mobilehome park, as specified.

Recommendation – No position.

Summary of Amendments

The March 25, 2019, amendments removed provisions of the bill that would have made a nonsubstantive technical change to the PITL, and replaced them with the provisions that would provide tax incentives for the sale of a mobile home park, as specified.

The April 22, 2019, amendments removed provisions that would have provided a gross income exclusion under the PITL and the CTL, modified the provision providing an exclusion for the gain on sale of a mobilehome park, and made other technical changes.

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

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

Reason for the Bill

The reason for this bill is to incentivize owners of qualified mobilehome parks to sell those parks to qualified purchasers who will operate those parks at affordable levels allowing residents to secure affordable housing.

Effective/Operative Date

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

Federal/State Law

Capital Gains

Federal law[1] provides rules governing the tax treatment of capital gains and losses, identifying holding periods, and determining the gain or loss from the sale or exchange of a capital asset. In general, property held for personal use or investment purposes is a capital asset.[2]

Examples of capital assets include held-for-investment stocks and securities as well as an owner-occupied personal residence.

Generally, capital gain is realized and recognized when a capital asset is sold or otherwise disposed of and the amount realized exceeds the basis of the asset and the amount subject to recapture under federal law. Basis in a capital asset is determined by the cost of the asset and is increased by further investment or decreased by allowable deductions. A capital loss results when a capital asset is sold or otherwise disposed of and the amount realized is less than the basis of the asset. Generally, any gain or loss from the sale or other disposition of property that does not qualify as a capital asset is ordinary gain or loss.

Property used in a taxpayer's trade or business is not a capital asset. However, federal law does provide, under Internal Revenue Code (IRC) section 1231, that certain dispositions may be treated as a capital asset. IRC section 1231 gains arise from: (1) the sale or exchange of depreciable personal or real property used in a trade or business (not mere investment) and held for more than one year; and (2) the conversion of business or investment property held for more than one year. IRC section 1231 losses are losses from the sale or exchange or conversion of business or investment property held for more than one year. Generally, all IRC section 1231 gains and losses must first be netted against each other in a taxable year. Then, if IRC section 1231 gains exceed IRC section 1231 losses, the net gains are treated as long–term capital gains. If IRC section 1231 losses exceed IRC section 1231 gains, the net losses are treated as ordinary losses. IRC section 1231 gains must be treated as ordinary income to the extent of the taxpayer's net IRC section 1231 losses in the preceding five years.

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[1] Internal Revenue Code (IRC sections 1201 through 1257.
[2] IRC section 1221(a).

Federal law (IRC section 1222) provides rules relating to the netting of capital gains and losses. Short-term capital gains are netted with short-term capital losses to arrive at net short-term capital gains/losses. Long-term capital gains are netted with long-term capital losses and net IRC section 1231 gains to arrive at net long-term capital gains/losses. Net short-term capital gains/losses and net long-term capital gains/losses are netted. If a net gain results, then that gain is included in income. If a net loss results, it is not currently deductible for corporations, but up to $3,000 may be deductible for individuals.

Under federal law, there are circumstances when a portion of a capital gain may be excluded from a taxpayer's gross income. For example, federal law allows a capital gain exclusion from the sale (or exchange) of property owned and used as a principal residence for at least two of the five years before the sale. An individual may exclude up to $250,000 of gain, while a married couple filing a joint return may exclude up to $500,000.

Other federal law provisions permit some or all of any realized capital gains to be deferred and recognized at a future date, such as like-kind exchanges under IRC section 1031 and involuntary conversions under IRC section 1033.

Complex rules allow non-corporate taxpayers to apply maximum tax rates that range from 0 percent to 28 percent to the taxation of a net capital gain; however, the rate on most net capital gain is 15 percent for most taxpayers.[3]

Under current federal law the tax on net capital gains for corporations is the same as on corporate ordinary income, which is 21 percent.

California generally follows federal law for defining capital assets, identifying holding periods, and determining the amount of gain or loss from the sale or exchange of a capital asset. However, under state law capital gains are taxed at the same rate as *ordinary income* regardless of the holding period of the asset.

Current California law, in Regulation Section 25106.5, relating to combined reporting, provides for the intrastate apportionment of business gains or losses from the sale or exchange of: (1) capital assets; (2) IRC section 1231 property; and (3) involuntary conversions, prior to the IRC section 1221 capital gain/loss netting provisions. Those gain/loss items are then netted at the entity level after intrastate apportionment.

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[3] Federal Topic *409 Capital Gains and Losses*-https://www.irs.gov/taxtopics/tc409

Under state law, capital gains for corporate taxpayers are taxed at the same rates as ordinary income (8.84 percent), with no maximum capital gain rate. Thus, under current federal and state law, corporate taxpayers are taxed on capital gains at the same rates as on ordinary income.

This Bill

For taxable years beginning on or after January 1, 2020, and before January 1, 2025, this bill, under the PITL and the CTL, would provide that gain from the sale of a qualified mobilehome park held by a taxpayer for a period of at least 30 years to a qualified purchaser would not be recognized.

The exclusion would apply only to a sale of a qualified mobilehome park that occurs during the taxable year for which the taxpayer seeks the exclusion and is confirmed by the Department of Housing and Community Development (DHCD).

The exclusion would only be allowed to a taxpayer that provides proof of an independent appraisal of the qualified mobilehome park to the DHCD.

A qualified purchaser would be required to comply with both of the following requirements:

- The purchaser agrees to own and operate a qualified mobilehome park and records a deed restriction to maintain affordable rents for at least 30 years.
- The purchaser applies to and is approved by the DHCD.

This bill would define the following terms and phrases:

- "Qualified mobilehome park" means a mobilehome park, as that term is defined in Health and Safety Code (HSC) section 18214 that is in existence as of January 1, 2020.
- "Qualified purchaser" means any of the following:
    - A local public entity, as defined in HSC section 50079, including a tribally designated housing entity.
    - A qualified nonprofit housing sponsor, as defined in HSC section 50781(k).
    - A resident organization, as defined in HSC section 50781(l).
    - A tribally designated housing entity, as defined in HSC section 50104.6.5.

The DHCD would be required to do all of the following:

- Develop and administer an application process pursuant to which an organization seeking to become a qualified purchaser may submit an application to the DHCD for approval.
- Confirm the information provided in an application for approval as a qualified purchaser.
- Designate as a qualified purchaser any applicant that the department determines meets the criteria specified in this section.
- Confirm the amount of exclusion to a taxpayer based on independent appraisal and the information provided in the application for the qualified purchaser to which the taxpayer sold the qualified mobilehome park.

The DHCD may adopt any regulations necessary or appropriate to implement this section. Regulations promulgated pursuant to this section shall not be subject to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

The Legislative Analyst, no later than January 1, 2025, would be required to submit a report to the Legislature on the effects of the exclusion on the sales of qualified mobilehome parks in this state. The report would be required to be submitted in compliance with Government Code section 9795.

This bill would be repealed by its own terms December 1, 2025.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill lacks administrative details necessary to administer the bill's provisions and determine its impacts to the department's systems, forms, and processes.

The department lacks the ability to determine whether the mobilehome park has been sold to a "qualified purchaser." Typically, bills involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. For clarity and ease of administration, the bill should be amended to include a certifying agency and specify that the following information be included on the certificate:

- Certificate number.
- Name, address, and social security number or taxpayer identification number of the seller of the qualified mobilehome park.

- Name, address, and social security number or taxpayer identification number of the qualified purchaser of the mobilehome park.
- The address or parcel number of the mobilehome park.

This bill uses terms and phrases that are undefined, i.e., "confirmed," "independent appraisal," "maintain affordable rents," and "amount of exclusion." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

The terms "confirmed" and "approved" are used interchangeably. For clarity and consistency with the author's intent, the bill should be amended.

The bill would require the taxpayer to hold the mobilehome park for at least 30 years prior to sale, and would require the qualified purchaser to maintain affordable rents for at least 30 years. If this is inconsistent with the author's intent, the bill should be amended.

The bill would require the qualified purchaser to have a deed restriction maintaining affordable rents for a 30-year period. It is unclear when the 30-year period would begin. For clarity and ease of administration, the author may want to specify that the deed restriction must be recorded at the time of sale for the purchaser to be considered a "qualified purchaser."

For consistency with terminology in the Revenue and Taxation Code, it is recommended that in paragraph (1) of subdivision (a) the phrase "gross income shall not include any gain" replace the term "gain" and the phrase "shall not be recognized."

Legislative History

Research of California legislation history found no legislation similar to the provisions of this bill.

Other States' Information

Review of *Florida, Illinois, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found no comparable tax incentives. These states were 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 the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

There would be a revenue loss but the amount is unknown.

Sales of mobilehome parks held for 30 years and sold to entities willing to hold the park for another 30 years cannot be predicted. To determine the magnitude of the potential impact to the General Fund, both the frequency of sales and the capital gains associated with those sales must be known. Since it is difficult to predict the frequency and the value of future mobile home parks sales, the revenue loss to the General Fund is unknown. However, it is estimated that for every $1 million in gain excluded the revenue loss would be $80,000.

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

Policy Concerns

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

If this bill is intended to provide an incentive for future decisions, the inclusion of either a binding contract date or a prospective operative date may be appropriate to more fully act as an inducement for future action or behavior, rather than providing a benefit for action taken without regard to this exclusion.

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