



Bill Analysis

Author: Hertzberg

Sponsor: None

Bill Number: SB 254

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Amended: July 27, 2020

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Related Bills: See Legislative
History

SUBJECT

Allowance of the Transfer of Tax Losses and Income Exclusion for Investment in Affordable Housing from Transfer of Tax Losses

SUMMARY

This bill would do the following:

- Allow for the transfer of tax losses to an unrelated party.
- Allow an exclusion equal to the amounts received from a tax loss transfer if the taxpayer invests that amount within 180 days of receipt in an affordable housing project or a corporation, partnership, or limited liability company (LLC) that is engaged in providing affordable housing.

In addition, the Franchise Tax Board (FTB) would be required to report specified information in accordance with Revenue and Taxation Code (R&TC) section 41.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The July 27, 2020, amendments removed provisions of the bill related to the Insurance Code and replaced them with the provisions discussed in this analysis.

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

REASON FOR THE BILL

The reason for this bill is to encourage taxpayers to invest in the development of affordable housing.

ANALYSIS

Transfer of Tax Losses (Bill Sections 1 and 3)

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow a taxpayer to transfer any tax loss to no more than one taxpayer that is an unrelated party. The bill would prohibit transfers of any portion of a tax loss to the extent that portion has already been claimed, is claimed, or will be claimed on any tax return of the transferor.

The bill would require the transferor to report to the FTB before the transfer of any tax loss, in the form and manner specified by the FTB, all required information regarding the transfer, including the social security number or other taxpayer identification number of the unrelated party to whom the transfer has been made and the amount of the tax loss transferred.

This bill provides that the FTB may disallow the loss of either taxpayer, if the statute of limitations remains open, if both the transferee and the transferor claim the same amount of tax loss on their tax returns.

For purposes of this bill, a "tax loss" means a loss computed pursuant to this part, including, but not limited to, a net operating loss (NOL).

The bill provides that the FTB may adopt regulations as necessary or appropriate to carry out the provisions of this bill. In addition, the Administrative Procedures Act would not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB pursuant to the provisions of this bill.

Exclusion Equal to Amounts Received from a Tax Loss Transfer if Invested in Affordable Housing (Bill Sections 2 and 4)

For taxable years beginning on or after January 1, 2021, and before January 1, 2026, this bill would, under the PITL and the CTL, provide that a taxpayer's gross income would exclude amounts received in exchange for a transferred tax loss, as defined above. That is, if the taxpayer invests that amount in an affordable housing project or in a corporation, partnership, or LLC that is engaged in providing affordable housing, as provided, within 180 days of receipt, then the amount can be excluded from gross income. In addition, the taxpayer would be required to provide verification to the FTB in the form and manner prescribed by the FTB.

This bill provides the following definitions:

- “Affordable housing” means housing with an affordable housing cost, as defined in Section 50052.5 of the Health and Safety Code (HSC), or affordable rent, as defined in Section 50053 of the HSC, to households whose gross income does not exceed 120 percent of the area median income.
- “Affordable housing project” means any project, whether by an individual, corporation, partnership, or limited liability company, to design, build, convert, or develop residential housing units for rent or sale as affordable housing.

Section 41 Requirements (Bill Section 5)

Section 5 of this bill contains language that would not be included in the numbered sections of the R&TC. It provides that, for purposes of R&TC section 41, the specific goal, purpose, and objective of the gross income exclusion provisions of the bill are to provide incentive for greater investment in the development of affordable housing. The detailed performance indicators for the Legislature to measure whether the gross income exclusion meets the specific goal, purpose, and objective would be the amount invested in affordable housing projects as measured by the amount excluded from gross income pursuant to the provisions of this bill. To assist the Legislature in measuring whether the goal, purpose, and objective of the bill would be met, the Legislative Analyst would be required to review the effectiveness of the gross income exclusion and would be allowed to request information from the FTB.

Data collection requirements would include the information on each affordable housing project that is required to be provided to the FTB pursuant to the provisions of the bill. Despite the general disclosure provisions under the R&TC, this bill would require the FTB to provide to the Legislative Analyst any data requested by the Legislative Analyst for purposes of their review.

Effective/Operative Date

If enacted on or before September 30, 2020, this bill would be effective January 1, 2021. The tax loss transfer and section 41 provisions would be operative January 1, 2021, and the gross income exclusion provisions would be specifically operative for taxable years beginning on or after January 1, 2021, and before January 1, 2026.

Federal/State Law

Currently, there are no federal or state provisions that allow for the transfer or sale of tax losses or for the exclusion of income comparable to the provisions that would be created by this bill.

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 uses the undefined term "unrelated party." In addition to the definition, does it apply to the entity (corporation, partnership, or LLC) involved as well? The term "invests" is also undefined, for example, are there any limitations on the invested amounts or majority ownership requirements? The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to define the term.

This bill defines a "tax loss" to mean "a loss computed pursuant to this part, including, but not limited to, a net operating loss." Therefore, "tax loss" as worded in the bill could include any type of loss such as NOLs, business losses, passive activity losses, and short-term and long-term capital losses. In addition, the bill is silent as to when the loss determination is made. If this is contrary to the author's intent, this bill should be amended.

Before transferring the tax loss, this bill requires the taxpayer to report, separate from the tax return, the transfer of the tax loss to the FTB with specific information. However, the bill is silent as to whether the FTB must respond, approve or certify the transfer. This step may not be necessary as the same information could be provided with the tax return or upon request of the FTB. The author may wish to amend the bill to eliminate this step.

This bill is also silent on what would happen if the transfer does not occur after being reported. The author may wish to amend the bill to provide additional clarification.

This bill provides that the FTB can disallow the loss if it is claimed by two taxpayers. However, the bill is silent as to the administrative details, e.g., guidance regarding who should be disallowed the loss and under what circumstances, how the disallowance would be done, and whether the disallowance could be challenged in an administrative proceeding. The author may wish to amend the bill for administrative clarity.

Some tax losses have specific characteristics, such as specified carryover periods, passive activity limitations, annual dollar limitations, short-term or long-term capital losses, limitations on NOL carryforwards and certain built-in losses following ownership changes. If it is the author's intent that these characteristics follow with the transferred tax loss, then the bill should be amended to provide additional clarification.

The FTB generally does not have the expertise to determine if amounts have been invested in an affordable housing project or in a corporation, partnership, or L that is engaged in providing affordable housing. Typically, tax benefits involving areas for which the department does not have expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

This bill does not specify if the amounts the taxpayer invests directly or amounts invested indirectly in an entity (corporation, partnership, or LLC) qualify for the low income housing credit, would the taxpayer also qualify for the income inclusion? The bill should be amended to clarify the author's intent.

The detailed performance indicators for the Legislature to use when measuring whether the gross income exclusions meet that specific goal, purpose, and objective of the bill shall be the amount invested in affordable housing projects as measured by the amounts excluded from gross income pursuant to the provisions of the bill. However, in compliance with R&TC section 41, the data reported would be related to "each" affordable housing project. If this is not the author's intent, the bill should be amended to include the desired reporting metrics.

Technical Considerations

In both SECTION 1, 17039.3. (a) (1) and SEC. 3, 23005. (a) (1):

Replace "The transferor shall report to the Franchise Tax Board before the transfer of the tax loss, in the form and manner specified by the Franchise Tax Board, all required information regarding the transfer, including the social security or other taxpayer identification number of the unrelated party to whom the transfer has been made and the amount of the tax loss transferred."

With "The transferor shall report to the Franchise Tax Board before the transfer of the tax loss, in the form and manner specified by the Franchise Tax Board, all required information regarding the transfer, including, but not limited to, the social security number or other taxpayer identification number of the unrelated party to whom the transfer has been made and the amount of the tax loss transferred."

Policy Concerns

This bill would establish an income exclusion for which federal law has no counterpart. In addition, federal law does not allow a taxpayer to claim the loss of another taxpayer. Thus, this bill would create another difference between federal and California tax law, thereby increasing the complexity of California tax return preparation.

LEGISLATIVE HISTORY

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

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This bill would require the implementation of a new program, which would require additional resources, such as staff; new systems, forms, and form instructions; and taxpayer outreach. As a result, this bill would likely significantly impact the department's systems, programming, and processing costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 254 as Amended on July 27, 2020
Assumed Enactment by September 30, 2020

(\$ in Millions)

Fiscal Year	Revenue
2020-2021	-\$6,000
2021-2022	-\$10,000
2022-2023	-\$9,500

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

Based on data from Personal Income and Corporate tax returns, it is estimated that approximately \$415 billion in NOLs will be available for transfer in 2021, and approximately 45 percent, or \$180 billion, would be transferred. At an average tax rate of approximately 6 percent, the associated loss of tax revenue is estimated to be about \$11 billion in the 2021 tax year.

The tax year estimates for 2021 were grown based on Department of Finance growth estimates, converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

LEGAL IMPACT

None noted.

LEGISLATIVE STAFF CONTACT

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