



## **Analysis of Original Bill**

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Sponsor:

Bill Number: SB 9

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Introduced: December 3, 2018

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Related Bills: See Legislative  
History

**Subject:** Low-Income Housing Credit/Remove Sunset Date

### **Summary**

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

**Recommendation – No position.**

### **Reason for the Bill**

The reason for the bill is to increase the impact of the LIHC by allowing the credit to be sold to unrelated parties in perpetuity.

### **Effective/Operative Date**

This bill would be effective on January 1, 2020, and operative for taxable years beginning on or after January 1, 2020.

### **Federal/State Law**

Current federal tax law allows an LIHC for the costs of constructing, rehabilitating, or acquiring low-income housing. The LIHC 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 LIHC is claimed over ten years.

The CA Tax Credit Allocation Committee (Allocation Committee)<sup>1</sup> allocates and administers the federal and state LIHC Programs.

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

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 (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 (15 years for federal), and the Allocation Committee must have authorized a federal credit to the taxpayer or the taxpayer must qualify for the federal credit. The LIHC is allocated in amounts equal to the sum of all the following:

- \$100 million,<sup>2</sup>
- The unused housing credit ceiling, if any, for the preceding calendar years,
- The amount of housing credit ceiling returned in the calendar year, and
- \$500,000 allocated to farmworker housing.

Current law requires allocation of the LIHC to partners 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.

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).

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

Additionally, for a project that receives a preliminary reservation on or after January 1, 2016, and before January 1, 2020, a taxpayer may make an irrevocable election in its application to the Allocation Committee to sell all or any portion of any LIHC allowed to one or more unrelated parties for each taxable year in which the LIHC is allowed subject to the following conditions:

- An LIHC is sold for consideration that is not less than 80 percent of the amount of the credit.
- The unrelated party or parties purchasing any or all of the LIHC, is a taxpayer allowed the state or federal<sup>3</sup> LIHC for the taxable year of the purchase or any prior taxable year in connection with a project located in this state. "Taxpayer allowed the credit" would mean a taxpayer that is allowed the credit without regard to the purchase of a credit.

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<sup>2</sup> The statutory \$70 million allocation amount adjusted by the Consumer Price Index through 2015.

<sup>3</sup> Allowed under Section 42 of the IRC.

The taxpayer that originally receives the LIHC would report to the Allocation Committee within 10 days of the sale, in the form and manner specified by the Allocation Committee, all required information regarding the purchase and sale of the LIHC, including:

- The social security or other taxpayer identification number of the unrelated party to whom the LIHC has been sold,
- The face amount of the LIHC sold, and
- The amount of consideration received by the taxpayer for the sale of the LIHC.

The Allocation Committee would provide an annual listing to the FTB, in a form and manner agreed upon by the Allocation Committee and the FTB, of the taxpayers that have sold or purchased an LIHC.

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.

The taxpayer that originally receives the LIHC that is sold remains solely liable for all obligations and liabilities imposed on the taxpayer with respect to the LIHC, none of which apply to any party to whom the LIHC has been sold or subsequently transferred. Parties purchasing an LIHC are entitled to utilize the purchased LIHC in the same manner as the taxpayer that originally received the LIHC.

A taxpayer cannot sell an LIHC if the taxpayer was allowed the credit on any tax return of the taxpayer.

The taxpayer, with the approval of the Executive Director of the Allocation Committee, may rescind the election to sell all or any portion of the LIHC allowed if the consideration falls below 80 percent of the amount of the LIHC after the Allocation Committee reservation.

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.

Existing federal and state laws provide that gross income includes all income from whatever source derived, including gains from property unless specifically excluded.

The sale of a credit is a sale of property, therefore, the seller is required to report gain from the sale. The gain from the sale of the credit is the excess of the total consideration received over the seller's basis in the credit. The total amount of consideration received is the sum of any money received plus the fair market value of the property (other than money) received. Since the seller's basis in the credit is \$0

(zero), the seller will recognize and report gain on the full amount of consideration received.

### **This Bill**

This bill, by removing the 2020 sunset date provisions in two places under current law and, as a result this bill would:

- Allow the LIHC to be sold in perpetuity and,
- Allow the LIHC to be allocated to partners in a partnership without regard to the substantial economic effect rules of IRC Section 704 (b) in perpetuity.

### **Implementation Considerations**

Implementing this bill would occur during the department's normal annual update.

### **Legislative History**

SB 377 (Beall, 2015/2016) would have modified the existing LIHC to allow the sale of the credit to unrelated parties. SB 377 was vetoed by Governor Brown on October 10, 2015, because "despite strong revenue performance over the past few years, the states' budget has remained precariously balanced due to unexpected costs and the provision of new services. Now, without the extension of the managed care organization tax that I called for in special session, the next year's budget faces the prospect of over \$1 billion in cuts. Given these financial uncertainties, I cannot support providing additional tax credits that will make balancing the state's budget even more difficult. Tax credits, like new spending on programs, need to be considered comprehensively as part of the budget deliberations."

SB 837 (Committee on Budget and Fiscal review, Chapter 32, Statutes of 2016), among other things, added provisions to allow the sale of the LIHC to unrelated parties for taxable years beginning on or after January 1, 2016, and before January 1, 2020.

SB 16 (Lowenthal, 2009/2010) would have made the LIHC refundable and would have extended the partnership allocation rules for the preliminary reservation of the state LIHC during tax year 2008. SB 16 failed passage out of the Senate by the constitutional deadline.

SB 622 (Lowenthal, 2009/2010) would have allowed projects that received a preliminary reservation of the state LIHC during calendar year 2008, for which financial closing had not occurred by the effective date of the bill, to be allocated to the partners of a partnership owning a low-income housing project. SB 622 failed passage out of the Senate by the constitutional deadline.

SB 585 (Lowenthal, Chapter 382, Statutes of 2008) requires a project that is owned by a partnership that receives a preliminary LIHC reservation on or after January 1, 2009, and before January 1, 2016, to allocate the LIHC to the partners of a partnership owning a low-income housing project, in accordance with a 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 under Internal Revenue Code section 704(b). In addition, SB 585 requires a deferral of any loss or deduction attributable to the sale, transfer, exchange, abandonment, or any other disposition of a partnership interest where the credit was allocated without substantial economic effect. The loss would be deferred until the first taxable year immediately following the end of the ten-year credit period for which the federal credit is allowed.

### **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, Michigan, and Minnesota*, lack a state LIHC.

*Illinois* currently 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. Donors may transfer some or all of their *Illinois* LIHC to another individual or entity. The individual or entity receiving the credit must make a donation to the affordable housing project at the time of transfer. If the amount transferred is less than \$100,000, the donation must be 10 percent of the amount transferred. The donation must be \$10,000 for transfers of amounts equal to or exceeding \$100,000. The administering agency must be informed in writing of all *Illinois* LIHC transfers.

*Massachusetts* offers a state LIHC. Developers of affordable rental housing developments apply to the Department of Housing and Community Development for tax credits. If they are awarded the credit, the developers (either for-profit or nonprofit) seek investors to help pay for the development of the housing. Intermediaries (known as syndicators) act as a bridge between investors and projects and often pool investors' money into equity funds. In exchange for providing development funds, the investors receive a stream of tax credits.

*New York* provides an LIHC for developers who acquire, build, or rehabilitate low-income rental housing. Developers sell these 10-year tax credits to investors for capital to fund additional construction.

### **Fiscal Impact**

This bill would not impact the department's costs.

## Economic Impact

### Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of SB 9 as Introduced December 3, 2018  
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	+ \$0.07
2020-2021	+ \$0.20
2021-2022	- \$0.50

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 California Tax Credit Allocation Committee, it is assumed that the maximum credit threshold of approximately \$110 million in LIHC would be reached in 2020. It is assumed that five percent, or \$6 million, would ultimately be returned to the Allocation Committee due to unforeseen project issues. Based on current credit awards and usage, it is estimated that 75 percent, or \$85 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 above table. Based on current LIHC usage, it is assumed that 70 percent, or \$60 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, or \$6 million, of the amount to be carried forward would be sold. It is assumed that the ability to sell the credit or allocate the credit amongst the partners would result in a timing difference because credits sold cannot be used until the building is put into service and the acceleration of credit use relative to current law would not begin until 2022, two years after the credit allocation. The revenue impact of the accelerated credit usage would not be fully phased in until taxable year 2025 (because credits must be taken over a four-year period). The fully phased-in revenue loss would be \$4.3 million in 2025.

Additionally, for credits that are sold, it is assumed that the taxpayer would have additional capital gain income, in the amount of 80 percent of the value of the credits sold. This capital gain income must be claimed in the year the credits are purchased, which would result in a positive revenue impact for the 2020 and 2021 taxable years.

The tax-year estimates are converted to fiscal-year estimates and rounded to arrive at the amounts reflected in the above table. The combined revenue impact from expanding the ability to sell the credit or allocate the credit amongst the partners results in a revenue gain of \$70,000 in fiscal year 2019-2020, transitioning to a revenue loss of \$500,000 in fiscal year 2021-2022, and then increasing to \$4 million revenue loss in fiscal year 2025-2026.

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