

DEPARTMENT OF TAXATION

2021 Fiscal Impact Statement

1. **Patron** Mamie E. Locke

2. **Bill Number** SB 1197

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

3. **Committee** Senate Finance and Appropriations

4. **Title** Virginia Housing Opportunity Tax Credit

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would provide a housing opportunity tax credit for certain low-income building projects in an amount substantially similar to the amount of federal low-income housing tax credit ("LIHTC") allocated or allowed by VHDA to such projects. To be qualified, the project would be required to be a qualified low-income building, as defined under federal law, that is:

- Located in Virginia;
- Placed in service on or after January 1, 2021; and
- Issued an eligibility certificate.

The credit would be allowed against the individual income tax, estate and trust income tax, corporate income tax, bank franchise tax, insurance premiums license tax, and license tax telegraph, telephone, water, heat, light, power, and pipeline companies.

For each qualified project, the credit would be allowable for up to 10, consecutive taxable years beginning with the date a building is placed in service or the following year, at the election of the taxpayer. The credit would not be subject to an annual credit cap.

This bill would be effective for taxable years beginning on or after January 1, 2021.

6. **Budget amendment necessary:** Yes.

7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

8. **Fiscal implications:**

Administrative Costs

The Virginia Housing Development Authority ("VHDA") would incur administrative costs of approximately \$200,000 per fiscal year beginning in Fiscal Year 2022. Such costs would be necessary to hire two full-time employees to help implement this new tax credit program.

The Department of Taxation (the “Department”) considers implementation of this bill as “routine,” and does not require additional funding. The State Corporation Commission (“SCC”) has indicated that it would not be impacted by this bill.

Revenue Impact

This bill would have an unknown, but potentially significant, negative General Fund revenue impact beginning in Fiscal Year 2022. The amount of credits under this bill would be based on the amount of federal LIHTCs provided each taxable year. Based on data from the Virginia Housing Development Authority and DHCD, \$32.7 million in federal LIHTCs were allocated to Virginia-based projects in 2019 as follows:

- Federal nine percent credits have historically been allocated to Virginia in an aggregate amount of approximately \$23 million per year.
- \$9.7 million in four percent credits were allocated to Virginia in 2019. However, the aggregate amount of federal four percent credits varies from year-to-year. In 2018, only \$3.3 million of such credits were allocated.

Accordingly, it is estimated that this bill would result in somewhere between \$20 million and \$30 million in state credits being allocated for new projects annually.

Unlike the annual caps that Virginia has typically imposed on recently enacted income tax credits, the allocation amounts under the federal credit would not limit the annual revenue impact of this bill to a specific dollar amount per fiscal year. Instead, the federal credit upon which the state credit under this bill would be based is generally claimed over a ten-year period, beginning with the year that the property is placed in service or, at the taxpayer’s election, the following year. Therefore, for each qualified project, the amounts allocated in one year could be claimed fully in that year but, unlike Virginia’s annual credit caps, such amounts could also be claimed again in each following year for up to ten consecutive taxable years. As a result, the revenue impact of allocations made in prior years can stack together with the revenue impact of allocations made during the current year. This would increase the revenue impact of the credit exponentially by approximately \$20 million to \$30 million annually, with a potential impact of \$200 million annually in the later years.

It is unclear whether this bill is intended to allow taxpayers to claim credits for projects that received federal credits prior to 2021. If the Virginia Housing Development Authority interprets the legislation to allow the issuance of such credits, this could substantially increase the impact in the initial years.

In addition, this bill would provide that there would be no reduction in the tax credit allowable in the first year of the credit period due to a calculation based on qualified occupancy under federal tax law. This could further increase the amount of credit claimed in the first year.

If the bill were amended to impose the maximum limitation on what taxpayers can claim for all taxable years for a particular project (“a project limit”) rather than applying the

limitation based on what taxpayers can claim each year during the credit period applicable to the project (“taxable year limit”), this would limit the revenue impact of the credit program to an estimated impact closer to the \$20 million to \$30 million range.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia Housing Development Authority

10. Technical amendment necessary: No.

11. Other comments:

Federal Low-Income Housing Tax Credit

The federal low-income housing tax credit (“LIHTC”) is a nonrefundable income tax credit that was created by the Tax Reform Act of 1986 to provide an incentive for the development and rehabilitation of affordable rental housing. LIHTCs are awarded to developers of qualified rental projects via a competitive application process administered by state housing finance authorities. Typically, developers will effectively “sell” their tax credits to outside investors by entering into limited partnerships or limited liability companies with investors, with 99.99 percent of the profits, losses, depreciation, and tax credits being allocated to the investors as a partner in the partnership or member in the limited liability company. This reduces the debt developers would otherwise have to incur and the equity they would otherwise have to contribute. With lower financing costs, tax credit properties can potentially offer lower, more affordable rents.

Two types of LIHTCs are available depending on the nature of the construction project. The so-called 9 percent credit is generally reserved for new construction, while the so-called 4 percent credit is typically used for rehabilitation projects and new construction that is financed with tax-exempt bonds. Each year, for ten years, a tax credit equal to roughly 4 percent or 9 percent of a project’s qualified basis (cost of construction) is claimed. The applicable credit rates have historically not actually been 4 percent and 9 percent. Instead, the credit rates have fluctuated in response to market interest movements so that the program has delivered a subsidy equal to 30 percent of the present value of a project’s qualified basis in the case of the 4 percent credit, and 70 percent in the case of the 9 percent credit. For both the 4 percent and 9 percent credit it is the subsidy levels (30 percent or 70 percent) that are explicitly specified under federal tax law, not the credit rates. Since 1986, the 4 percent rate has ranged between 3.15 percent and 3.97 percent, and the 9 percent credit between 7.35 percent and 9.27 percent. Since 2008, however, there has been a floor under the 9 percent credit below which the new construction credit rate cannot fall.

The process of allocating, awarding, and then claiming the LIHTC is complex and lengthy. The process begins at the federal level with each state receiving an annual LIHTC allocation in accordance with federal law. State housing agencies then allocate credits to developers of rental housing according to federally required, but state created, allocation plans. The process typically ends with developers effectively selling allocated credits to outside investors in exchange for equity.

Taskforce and Report to Study Establishment of Virginia LIHTC

During the 2020 General Assembly Session, House Bill 810 was enacted, which required the Department of Housing and Community Development (“DHCD”) and the Virginia Housing Development Authority (“VHDA”) to convene a stakeholder advisory group (“Task Force”) to:

- Determine the most effective and efficient way to administer a Virginia housing opportunity tax credit program,
- Develop draft legislation establishing such an affordable housing credit program, and
- Conduct financial modeling to determine the fiscal impact of such a program to Virginia.

Such legislation also required the Task Force to report its recommendations to the Governor, the Secretary of Commerce and Trade, the Director of the DHCD, and the commissioners of the VHDA by September 1, 2020. Such report, the *Report of the Virginia Housing Opportunity Tax Credit Task Force*, was published in September 2020.

Policy for Ordering the Application of Credits

In Public Document ("PD") 95-240 (9/22/95), the Department set forth a comprehensive policy with respect to Virginia income tax credits. In PD 04-32 (07/14/ 04), this policy was extended to the bank franchise tax. Under that policy, taxpayers may claim credits with a carryforward feature only after first claiming all nonrefundable credits. Such policy is generally beneficial to taxpayers because it allows them to apply nonrefundable credits first, the tax benefit of which would otherwise be lost if such credits are not able to be applied during the current taxable year.

Sunset Dates for New Income Tax Credits and Sales Tax Exemptions

Section 3-5.14 of the 2020 Appropriation Act provides that any new sales tax exemption or tax credit enacted by the General Assembly after the 2019 Session, but prior to the 2024 Session, must have a sunset date of not later than June 30, 2025. Further, during the 2012 Session, the General Assembly enacted House Bill 246, which prohibits any committee of the General Assembly from reporting any legislation that would add a new credit or renew an existing credit unless the legislation contains a sunset date of no longer than five years from the effective date of the new or renewed credit.

Proposed Legislation

This bill would provide a housing opportunity tax credit for certain low-income building projects in an amount substantially similar to the amount of federal LIHTC allocated or allowed by VHDA to such projects. This bill would allow a credit for each project for each year of the federal credit period, in an amount equal to the amount of federal LIHTC allocated or allowed by VHDA to such project. Therefore, for each qualified project, the credit would be allowable for up to 10, consecutive taxable years beginning with the date a building is placed in service or the following year, at the election of the taxpayer.

However, the bill would provide that there would be no reduction in the tax credit allowable in the first year of the credit period due to a calculation based on qualified occupancy under federal tax law.

The credit would not be subject to an annual credit cap.

The credit would be allowed against the individual income tax, estate and trust income tax, corporate income tax, bank franchise tax, insurance premiums license tax, and license tax telegraph, telephone, water, heat, light, power, and pipeline companies. This bill would provide that an insurance company claiming a the credit established under this bill against the taxes, licenses, and other fees, fines, and penalties imposed by the law regarding the Virginia Insurance Premium License Tax, including any retaliatory tax imposed on insurance companies would not be required to pay any additional tax as a result of claiming this credit. The housing opportunity tax credit would be permitted to fully offset any retaliatory tax imposed by Virginia.

To be qualified, the project would be required to be a qualified low-income building, as defined under federal law, that is:

- Located in Virginia;
- Placed in service on or after January 1, 2021; and
- Issued an eligibility certificate.

The eligibility certificate would be a certificate issued by the VHDA to the owner of a qualified project certifying that such project qualifies for the credit authorized under this bill and specifying the amount of credit that the owner of such qualified project may claim in each year of the credit period. The VHDA would be required to issue an eligibility certificate to a qualified project upon the VHDA approval of a final cost certification that complies with the VHDA requirements.

The credit would only be permitted to be claimed by a taxpayer owning an interest, direct or indirect through one or more pass-through entities, in the project at any time prior to filing a tax return claiming a housing opportunity tax credit.

The credit under this bill would be applied first, prior to reduction by any other credits allowed the taxpayer. Therefore, with respect to this credit, this bill would supersede the application of the Department's general policy for ordering the application of credits set forth in P.D. 95-240.

The credit would be allocated by pass-through entities to some or all of its partners, members, or shareholders in any manner agreed to by such persons, regardless of whether or not:

- Any such person is allocated or allowed any portion of any federal low-income housing tax credit with respect to the qualified project;
- The allocation of the housing opportunity tax credit under the terms of the agreement has substantial economic effect within the meaning of § 704(b) of the Internal Revenue Code; and

- Any such person is deemed a partner for federal income tax purposes as long as:
 - The partner or member would be considered a partner or member as defined under applicable federal law; and
 - Has been admitted as a partner or member on or prior to the date for filing the qualified taxpayer's tax return, including any amendments thereto, with respect to the year of the housing opportunity tax credit.

Such pass-through entities or qualified taxpayer would be permitted to assign all or any part of its interest, including its interest in the tax credits, to one or more pass-through entities or qualified taxpayers, and the qualified taxpayer would be able to claim the credit so long as its interest is acquired prior to the filing of its tax return claiming the credit.

The amount of the credit that may be claimed in any single taxable year would be limited to the taxpayer's eligible tax liability for such taxable year. Any credits not used in a taxable year would be allowed to be carried forward for the succeeding five years.

A taxpayer claiming the credit established by this bill would be required to submit a copy of the eligibility certificate at the time of filing its tax return with the Department. If the owner of the qualified project has applied to the VHDA for the eligibility certificate but the VHDA has not yet issued the eligibility certificate at the time the taxpayer files its original tax return claiming the credit, the taxpayer would be allowed to claim the credit based upon the amount of credit set forth in the carryover allocation or 42(m) letter, as applicable, issued to the qualified project and would be required to amend its tax return to include the eligibility certificate upon its receipt. If the amount of tax credit in the eligibility certificate is different than the amount of tax credit previously claimed, the taxpayer would be required to adjust the tax credit amount claimed on the amended tax return.

If a portion of any federal low-income housing credits taken on a qualified project is required to be recaptured or is otherwise disallowed during the credit period, the taxpayer claiming credits under this bill with respect to such project would be required to recapture a portion of such credits. The percentage of credits subject to recapture would be equal to the percentage of federal low-income housing credits subject to recapture or otherwise disallowed during such period. Any tax credits recaptured or disallowed would increase the income tax liability of the qualified taxpayer who claimed the tax credits in a like amount and would be required to be included on the tax return of the taxpayer submitted for the taxable year in which the recapture or disallowance event is identified.

The VHDA would be required to administer the tax credit program established by this bill and would be authorized to promulgate the regulations and guidelines necessary to implement and administer this bill.

This bill would be effective for taxable years beginning on or after January 1, 2021.

Similar Legislation

House Bill 2050 is substantially similar to this bill, except that the partner or member would have to be considered a partner or member as defined under applicable Virginia

law, rather than federal law as this bill states, to be exempt from the requirement that such person be deemed a partner for federal income tax purposes.

cc : Secretary of Finance

Date: 1/23/2021 JJS
SB1197F161