

DEPARTMENT OF TAXATION

2021 Fiscal Impact Statement

1. **Patron** Mamie E. Locke

3. **Committee** Passed House and Senate

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

2. **Bill Number** SB 1197

House of Origin:

 Introduced

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 X **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 the Virginia Housing Development Authority ("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 be subject to an annual credit cap of \$15 million per calendar year.

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

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. **Fiscal implications:**

Administrative Costs

Because this bill would allow the Virginia Housing Development Authority ("VHDA") to impose application, allocation, certification, and monitoring fees designed to recoup the costs of the VDHA in administering the tax credit program proposed by this bill, it is not

anticipated that VHDA would incur General Fund administrative costs related to this bill.

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 estimated negative General Fund revenue impact of \$15 million annually. The negative impact could begin as early as Fiscal Year 2022 depending on how VHDA administers the credit. It is the Department understanding that the House Substitute for this bill included a \$7.5 million cap that was intended to limit the revenue impact to \$7.5 million annually. The enrolled bill maintains a similar cap, but increased the amount to \$15 million. Therefore, the Department understands that the bill was intended to have a revenue impact to no more than \$15 million annually. This would be consistent with how all other capped credits are administered, where the cap limits the annual revenue impact to a specific dollar amount. The Department understands that the 2021 Appropriation Act (Chapter 552, 2021 Acts of Assembly, Special Session I) includes the \$15 million revenue adjustment required by this bill.

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 be subject to a \$15 million 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 state 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. Such regulations and guidelines would be allowed to include the imposition of application, allocation, certification, and monitoring fees designed to recoup the costs of VHDA in administering the housing opportunity tax credit program. VHDA would also be allowed to promulgate regulations and guidelines in consultation with the Department to allow a qualified project to elect in its application to the VHDA to sell all or any portion of its credits awarded pursuant to this bill to one or more unrelated taxpayers. Regulations and guidelines regarding the sale of credits, if promulgated, would not be allowed to take effect prior to January 1, 2023, and would not apply to credits awarded prior to January 1, 2023.

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

cc : Secretary of Finance

Date: 5/17/2021 JJS
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