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**DEPARTMENT OF TAXATION**
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To: The Honorable Jill N. Tokuda, Chair
and Members of the Senate Committee on Ways and Means

Date: Wednesday, March 30, 2016
Time: 9:00 A.M.
Place: Conference Room 211, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 2744, H.D. 1 S.D. 1, Relating to Housing.

The Department of Taxation (Department) appreciates the intent of the measure but has concerns regarding the nonconformity to the Internal Revenue Code (IRC) provisions relating to the at-risk and passive activity loss (PAL) limitation rules. The Department defers to the Hawaii Housing Finance and Development Corporation (HHFDC) on the merits of this bill and provides the following comments for your consideration.

H.B. 2744, H.D. 1, S.D. 1, distinguishes the amount of the State low-income housing tax credit (LIHTC) based on whether or not a building is financed by tax-exempt bonds, doubles the amount of the credit with respect to buildings financed by tax-exempt bonds, reduces the term over which the credit is taken from ten to five years to increase the attractiveness of the credit, and provides that the IRC at-risk and PAL rules do not apply. The measure has a defective effective date of July 1, 2050.

Two types of Low Income Housing Credits (LIHTCs) are available depending on the nature of the rental housing construction. The so-called 9% credit is generally reserved for new construction and is intended to subsidize 70% of a building's cost (not including land), while the so-called 4% credit is typically claimed for rehabilitated housing and new construction that is financed with tax-exempt bonds, and is intended to subsidize 30% of a building's cost (not including land). Each LIHTC project will fall into either the 9% category or the 4% category depending upon how the project is financed. The 9% and 4% categories are further divided by the construction method of the project- new construction or rehabilitating an existing structure, with rehabilitation completion within 24 months in order to be eligible for tax credits.

Currently, both the 9% credit and the 4% credit is claimed annually over a 10-year credit period. The actual credit rate fluctuates and is set by the United States Treasury to deliver a subsidy equal to 70% and 30% respectively of a project's qualified basis in present value terms. For State tax purposes, the amount of the credit is set at 50% of the federal tax credit. Other than projects financed with tax exempt bonds, both the 9% and the 4% credit is subject to the federal allocation limit for the State, which for 2016 is $3,264,990. Although credits allocated for projects financed with tax-exempt bonds is not included in this cap, the total amount of the credit that can be allocated is limited by the amount of federal tax free Private Activity Bonds that may be issued by the State.

With regards to credits that are subject to the allocation cap (i.e. non tax exempt bond financed), the LIHTC is fully subscribed and the State will be unable to generate additional investment with respect to the 9% credit. Only projects that are financed with tax-exempt bonds are under subscribed, such that additional inducements may attract additional investors. The Department notes that implementing multiple incentives at the same time may prevent an examination of how effective any particular incentive was, and whether in fact it was required.

The Senate Committee on Housing amended this measure by providing that the at-risk rules found at IRC section 41(k) and the PAL rules of IRC section 469 do not apply. The Department notes that it always prefers conformity to the IRC where possible, as this provides clear guidance to both the Department and to taxpayers, since there is substantial guidance issued in the form of rules and regulations issued by the Internal Revenue Service (IRS), as well as court decisions regarding the various sections of the IRC. Conformity greatly minimizes the burden on the Department and taxpayers, thereby assisting compliance with Hawaii's tax law.

Both the at risk and PAL rules apply to:

- Individuals (including partners and S corporation shareholders);
- Estates;
- Trusts (other than grantor trusts);
- Personal service corporations; and
- Closely held corporations.

It should first be noted that the measure is unclear whether the relaxation of the at-risk and PAL limitation rules apply only for buildings allocated tax credits after December 31, 2016, or is applicable to all taxpayers. Currently, losses from activities that exceed the amount the taxpayer has at-risk are disallowed for the current year, but are carried forward until the taxpayer increases the amount that the taxpayer has at-risk, at which time the losses up to that amount may be utilized. Similarly, losses from passive activities that exceed the income from passive activities are disallowed for the current year, but are carried forward until they may be used against passive income or the interest in the activity has been disposed of. If the relaxation of the at-risk and PAL rules applies to all holders of the LIHTC, taxpayers would be able to immediately use the carried over amounts to the full extent of their ordinary income. If the Legislature is inclined to relax these rules, the Department strongly urges that it be limited only to buildings allocated credits after December 31, 2016 to avoid fiscal implications.

Congress originally enacted the at-risk provisions as part of the Tax Reform Act of 1976 in order to deter deductions from losses generated by tax shelters. Prior to the enactment, a taxpayer could increase his or her basis in the partnership by utilizing nonrecourse loans for which the individual had no true economic risk. This increase in basis allowed the taxpayer to use investment losses to offset ordinary income. Although the IRS attempted to limit this practice, its attempts were only marginally effective until the enactment of IRC section 465.

Currently, nonrecourse financing is treated as at-risk only if the property is acquired by the taxpayer from a non-related person, and the financing is received from a lender in the business of lending (other than the seller of the property) or a government agency. If the at-risk rules are relaxed for the LIHTC, the investor could acquire the property from a related person at a greatly inflated price using nonrecourse liability (such that no individual partner has a liability in the event of default), and yet take virtually unlimited losses in connection with the property. In addition, the at-risk rules prevent a taxpayer from artificially increasing basis through the use of subscription promissory notes (whereby an investor promises to pay an amount in the future) which in fact are never paid. See e.g. Zeluck v. Commissioner, 103 TCM (2012), where the taxpayer contributed $310,000 to a partnership in 2001 in the form of $110,000 in cash and a $200,000 note that matured on December 31, 2009. The taxpayer also guaranteed a note that was issued by the partnership up to an amount equal to the note he contributed, giving him an initial at risk tax basis of $310,000 ($110,000 of cash plus $200,000 of guaranteed debt). In 2001 and 2002, the taxpayer was allocated losses from the partnership that practically eliminated his at-risk tax basis, and in 2003 the partnership terminated. After the partnership terminated, no attempt was made to enforce payment of the taxpayer's note or the partnership's note on which the taxpayer never made any principal payments and failed to make all interest payments.

The PAL rules were enacted as part of the Tax Reform Act of 1986 to address widespread avoidance of tax through the generation of artificial losses from tax shelters and other trades or business for which the taxpayer did not bear sufficient economic risk. The PAL rules focus on the source and character of losses rather than on the taxpayer's wherewithal to recognize such losses. Broadly speaking, the rules operate to prevent taxpayers from offsetting ordinary income from non-passive activities (i.e., wages or businesses they operate) with losses from passive activities in which the taxpayer does not materially participate, thereby insuring that all taxpayers pay a fair share of taxes on ordinary income. It should also be noted that if the PAL limitation rules are relaxed, a taxpayer will be able to shield their ordinary income and yet obtain capital gain treatment when the interest in the activity is sold.

Under section 201H-36, Hawaii Revised Statutes, HHFDC certifies that a housing project is entitled to the GET exemption, and upon such certification, a taxpayer is entitled to claim the GET exemption. The regulatory agreements and the determination of whether a taxpayer is eligible for the exemption remain with HHFDC, and as such, the Department will be able to implement any changes without any undue burden.

With the original effective date, the Department estimates losses of $9 million in FY 2019, $18 million in FY 2020 and $27 million in FY 2021. The elimination of at-risk rules will increase the cost of the tax credit, but we are unable to determine the amount at this time.

Thank you for the opportunity to provide comments.

**DAVID Y. IGE**
GOVERNOR

**CRAIG K. HIRAI**
EXECUTIVE DIRECTOR

# STATE OF HAWAII

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND TOURISM
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION
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Honolulu, Hawaii 96813
FAX: (808) 587-0600

IN REPLY REFER TO:

Statement of
**Craig K. Hirai**
Hawaii Housing Finance and Development Corporation
Before the

**SENATE COMMITTEE ON WAYS AND MEANS**
March 30, 2016 at 9:00 a.m.
State Capitol, Room 211

In consideration of
**H.B. 2744, H.D. 1, S.D. 1**
**RELATING TO HOUSING.**

The HHFDC ***offers comments on*** H.B. 2744, H.D. 1, S.D. 1. This bill amends statutes relating to the State Low-Income Housing Tax Credit (LIHTC) program, which HHFDC administers. The LIHTC program is an important source of equity financing for affordable rental projects for households at or below 60 percent of the area median income.

H.B. 2744, H.D. 1, S.D. 1, increases the value of the State LIHTC by accelerating both the 9% volume cap and the 4% non-volume cap LIHTCs which are coupled with the use of Hula Mae Multifamily revenue bonds. By making the State LIHTC more valuable, these provisions are consistent with the Governor's housing strategy to build homes that people can afford, including rentals, to address the needs of those entering the work force.

The measure also doubles the amount of the State 4% non-volume cap LIHTCs and repeals certain provisions that require conformity of the State LIHTC to the Federal LIHTC. We defer to the Department of Taxation on those provisions of the S.D. 1 affecting tax enforcement and administration, as well as its fiscal impact.

Thank you for the opportunity to provide written comments on this bill.

CATHOLIC CHARITIES HAWAIʻI

**TESTIMONY in SUPPORT of HB 2744, HD1 SD1: RELATING TO HOUSING**

TO: Senator Jill N. Tokuda, Chair, Senator Donovan Dela Cruz, Vice Chair, and Members, Committee Ways and Means

FROM: Betty Lou Larson, Legislative Liaison, Catholic Charities Hawaii

**Hearing: Wednesday, 3/30/16; 9:00 AM; Conference Room 211**

Thank you for the opportunity to provide written testimony **in support of HB 2477, HD1, SD1,** which would make the State Low-Income Housing Tax Credits more valuable. I am Betty Lou Larson representing Catholic Charities Hawaii.

Catholic Charities Hawai`i (CCH) is a tax exempt, non-profit agency that has been providing social services in Hawai`i for over 60 years. CCH has programs serving elders, children, developmentally disabled, homeless and immigrants. Our mission is to provide services and advocacy for the most vulnerable in Hawai`i. A priority for advocacy this year is affordable housing and homelessness.

Catholic Charities supports the intent of this bill. Costs for construction are going up. More funds are needed to develop critically needed affordable rental untis. By creating more incentives for investments in the State Low Income Housing Tax Credits (LIHTC), additional much needed capital could be generated to produce more affordable rental units. By reducing the State tax credit period from ten years to five years, this makes these credits more valuable. Investors receive the same credit and the State "suffers" the same loss of revenue, but over 5 years instead of 10 years. The impact is to increase the amount that investors will pay for these state credits. The federal Low Income Housing Tax Credits are so valuable that they are currently selling for close to $1.00 for $1.00 of credits!

We note that SB 2833, an administration bill, is also being heard by the House on this issue. These bills would enhance the potential to leverage all available resources to create housing. To end homelessness and to help our children remain in Hawaii, the key is construction of more affordable rentals. Hawaii already has the most expensive housing in the country, at more than twice the national average. Rent for a 2 bedroom unit rose 67% in Honolulu in the last 10 years. We need to action now.

Thank you very much for hearing and considering this bill to provide more resources for the creation of affordable rental housing. Please contact me at (808) 373-0356 or bettylou.larson@catholiccharitieshawaii.org if you have any questions.

Chamber of Commerce HAWAII
The Voice of Business

# Testimony to the Senate Committee on Ways & Means
# Wednesday, March 30, 2016 at 9:00 A.M.
# Conference Room 211, State Capitol

**RE: HOUSE BILL 2744 HD 1 SD 1 RELATING TO HOUSING**

Chair Tokuda, Vice Chair Dela Cruz, and Members of the Committee:

The Chamber of Commerce Hawaii ("The Chamber") **strongly supports** HB 2744 HD 1 SD 1, which bases the amount of the state low-income housing tax credit (LIHTC) on whether or not a building is financed by tax-exempt bonds. Increases funding for affordable rental housing development by making the state LIHTC more valuable by reducing the term over which the state LIHTC may be taken from ten to five years.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber of Commerce of Hawaii and the Building Industry Association of Hawaii convened a conference (Houseless in Honolulu) in November of 2015 to raise awareness of one of Hawaii's most pressing issues - home affordability. With the median home price in the Islands now $730,000, the repercussions are having a major impact on Honolulu's economy.

The Department of Business, Economic Development and Tourism forecasted demand for additional housing units by county is 25,847 units for Honolulu, 19,610 for Hawaii, 13,949 for Maui, and 5,287 for Kauai during the 2015-2025 period (DBEDT Report—Measuring Housing Demand in Hawaii, 2015-2025).

We believe that in order to address the current "Housing Crisis," there needs to be a shift in the focus of how government views housing development and move from our current "Regulatory" stance to a more "Production Oriented" stance. For example, this shift would have the City and County of Honolulu adopt a goal of approving an average of 2,500 new residential units each year over the next 10 year period to address the project 25,847 unit demand.

Creating more incentives for investments in the State Low-Income Housing Tax Credit would provide the needed capital investment to produce more units at these price points.

We are in strong support of H.B. 2744 HD 1 SD 1 and appreciate the opportunity to express our views on this matter.

Hawai‘i Association of REALTORS®
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March 30, 2016

**The Honorable Jill N. Tokuda, Chair**
Senate Committee on Ways and Means
State Capitol, Room 211
Honolulu, Hawaii 96813

**RE: H.B. 2744, H.D.1, S.D.1, Relating to Housing**

**HEARING: Wednesday, March 30, 2016 at 9:00 a.m.**

Aloha Chair Tokuda, Vice Chair Dela Cruz, and Members of the Committee:

I am Myoung Oh, Government Affairs Director, submitting written testimony on behalf of the Hawai‘i Association of REALTORS® ("HAR"), the voice of real estate in Hawai‘i, and its 8,900 members. HAR **supports** H.B. 2744, H.D.1, S.D.1, which bases the amount of tax credit on whether or not a building is financed by tax-exempt bonds, increases funding for affordable rental housing development by making the state low income housing tax credit more valuable, and reduces the state tax credit period from 10 to 5 years.

The State Low Income Housing Tax Credit (LIHTC) has been a valuable financing mechanism to generate the development or substantial rehabilitation of affordable rental housing. HAR believe this is one of the key incentives in encouraging developers to build affordable housing and rentals.

Under the program, HHFDC awards federal and state tax credits that may be used to obtain an offset in income tax liability for 10 years or may be syndicated to generate substantial project equity.

HAR believes H.B.2744, H.D.1, S.D.1 will allow for a shorter recapture period for tax credits and to incentivize the development of affordable rental housing statewide.

Mahalo for the opportunity to submit written testimony.

LAND USE RESEARCH
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March 29, 2015

Senator Jill N. Tokuda, Chair
Senator Donovan M. Dela Cruz, Vice Chair
Senate Committee on Ways and Means

**Strong Support of HB 2744, HD1, SD1 Relating to Housing (Bases the amount of the state low-income housing tax credit (LIHTC) on whether or not a building is financed by tax-exempt bonds. Increases funding for affordable rental housing development by making the state LIHTC more valuable by reducing the term over which the state LIHTC may be taken from ten to five years.)**

**WAM Hrg: Wednesday, March 30, 2015 at 9:00 a.m., in Conf. Rm. 211**

The Land Use Research Foundation of Hawaii (LURF) is a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

Since the 1970's LURF's members have built housing for low, moderate and all income levels in the State, and have strongly supported affordable housing, including sale or lease for persons with eighty per cent (80%) Area Median Income (AMI) and below, as determined by the United States Department of Housing and Urban Development (HUD). LURF members continue to successfully partner with the Hawaii Public Housing Authority (HPHA) and the Hawaii Housing Finance and Development Corporation (HHFDC) on various affordable housing projects.

LURF appreciates the opportunity to **strongly support HB 2744, HD1, SD1**, as this measure will incentive and allowing the development of new, as well as reviving the construction of stalled affordable housing projects.

**HB 2744, HD1, SD1.** This bill bases the amount of the State LIHTC on whether or not a building is financed by tax-exempt bonds; and shortens the term over which the LIHTCs are taken from ten years to five years, thereby making the State LIHTC more valuable, therefore increasing the amount of equity generated by the LIHTCs and increasing funding for affordable rental housing development.

**LURF's Position.** The development of low-income affordable housing is necessary to address the issue of homelessness and respond to the critical shortage of housing inventory affecting Hawaii and Hawaii's families. Finding ways to provide sufficient affordable housing and market housing for Hawaii's residents has been a major objective for our elected officials, and state and county agencies, and members of the housing industry and business community.

Over the years, the State's LIHTC program, established pursuant to Hawaii Revised Statutes, Section 235-110.8, has been a valuable financing mechanism to generate the development or substantial rehabilitation of affordable rental housing. LURF understands, however, in recently tougher economic times, there has been lower demand for state LIHTCs due to the lack of available private investors willing to purchase the tax credits, or the fact that equity generated by any sale of such credits is insufficient to fund development projects. The development and rehabilitation of affordable rental housing projects has thus been stalled generally, due to lack of project equity. Given the current economic circumstances, the State LIHTC Program, in its present form, is unable to create or preserve low-income housing as initially intended.

Legislative changes to our existing laws, such as the changes proposed by this bill, are critically necessary to help increase the diminished supply of affordable housing in Hawaii. Increasing the investment attractiveness of the State's LIHTCs would generate more equity to finance the development of affordable rental housing projects; and incentivize the development, construction and completion of affordable housing.

**Conclusion.** Based on the above, LURF **strongly supports HB 2744, HD1, SD1**, because it would stimulate the development and construction of affordable housing projects, particularly given the current state of the economy and the dire need for affordable housing.

Thank you for the opportunity to present testimony regarding this important matter.

BIA-HAWAII
BUILDING INDUSTRY ASSOCIATION
THE VOICE OF THE CONSTRUCTION INDUSTRY



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**Testimony to the Senate Committee on Ways and Means**
**Wednesday, March 30, 2016**
**9:00 a.m.**
**State Capitol - Conference Room 211**

**RE: H.B. 2744 H.D. 1 S.D. 1 – Relating to Housing.**

Dear Chair Tokuda, Vice-Chair Dela Cruz, and members of the Committee:

My name is Gladys Marrone, Chief Executive Officer for the Building Industry Association of Hawaii (BIA-Hawaii), the Voice of the Construction Industry. We promote our members through advocacy and education, and provide community outreach programs to enhance the quality of life for the people of Hawaii. BIA-Hawaii is a not-for-profit professional trade organization chartered in 1955, and affiliated with the National Association of Home Builders.

BIA Hawaii is in **strong support** of H.B. 2744 H.D. 1 S.D. 1, which propose to base the amount of the state low-income housing tax credit (LIHTC) on whether or not a building is financed by tax-exempt bonds. Increases funding for affordable rental housing development by making the state LIHTC more valuable by reducing the term over which the state LIHTC may be taken from ten to five years.

The Building Industry Association of Hawaii and the Chamber of Commerce of Hawaii convened a conference (Houseless in Honolulu) in November of 2015 to raise awareness of one of Hawaii's most pressing issues - home affordability. With the median home price in the Islands now $730,000, the repercussions are having a major impact on Honolulu's economy.

The Department of Business, Economic Development and Tourism forecasted demand for additional housing units by county is 25,847 units for Honolulu, 19,610 for Hawaii, 13,949 for Maui, and 5,287 for Kauai during the 2015-2025 period (DBEDT Report—Measuring Housing Demand in Hawaii, 2015-2025).

We believe that in order to address the current "Housing Crisis," there needs to be a shift in the focus of how government views housing development and move from our current "Regulatory" stance to a more "Production Oriented" stance. For example, this shift would have the City and County of Honolulu adopt a goal of approving an average of 2,500 new residential units each year over the next 10 year period to address the project 25,847 unit demand.

Creating more incentives for investments in the State Low-Income Housing Tax Credit would provide the needed capital investment to produce more units at these price points.

We are in strong support of H.B. 2744 H.D. 1 S.D. 1, and appreciate the opportunity to express our views on this matter.

HAWAII LABORERS-EMPLOYERS COOPERATION AND EDUCATION TRUST
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**TESTIMONY OF HAWAII LECET**
**CLYDE T. HAYASHI – DIRECTOR**

THE SENATE
THE TWENTY-EIGHTH LEGISLATURE
REGULAR SESSION OF 2016

COMMITTEE ON WAYS AND MEANS
Senator Jill N. Tokuda, Chair
Senator Donovan M. Dela Cruz, Vice Chair

NOTICE OF DECISION MAKING

DATE: Wednesday, March 30, 2016
TIME: 9:00 a.m.
PLACE: Conference Room 211
State Capitol
415 South Beretania Street

**TESTIMONY ON HOUSE BILL NO. 2744 HD1 SD1, RELATING TO HOUSING.**

TO THE HONORABLE JILL TOKUDA, CHAIR, DONOVAN DELA CRUZ, VICE CHAIR, AND MEMBERS OF THE COMMITTEE ON WAYS AND MEANS:

My name is Clyde T. Hayashi, and I am the Director of Hawaii Laborers' Cooperation and Education Trust (LECET). Hawaii LECET is a labor-management partnership between the Hawaii Laborers Union, Local 368, and its unionized contractors.

Mahalo for the opportunity to testify in **STRONG SUPPORT** of House Bill No. 2744, HD1 SD1 which bases the amount of the state low-income housing tax credit (LIHTC) on whether or not a building is financed by tax-exempt bonds. H.B. 2744 HD1 SD1 also seeks to increase funding for affordable rental housing development by making the State LIHTC more valuable by shortening the State Tax Credit period from ten to five years.

Hawaii LECET is a strong supporter of developments that provide affordable housing and strongly supports the intent of this bill. Hawaii has the most expensive housing costs in the nation and Hawaii LECET believes that construction of more affordable rentals and housing units is one of the keys to end the homeless crisis facing Hawaii residents today. Many of our members and their families also struggle to find affordable housing.

For this reason, Hawaii LECET strongly supports House Bill No. 2744 HD1 SD1 and respectfully urges your favorable consideration.