DAVID Y. IGE
GOVERNOR

DOUGLAS S. CHIN
LIEUTENANT GOVERNOR

LINDA CHU TAKAYAMA
DIRECTOR

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
830 PUNCHBOWL STREET, ROOM 221
HONOLULU, HAWAII 96813
http://tax.hawaii.gov/
Phone: (808) 587-1540 / Fax: (808) 587-1560
Email: Tax.Directors.Office@hawaii.gov

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Friday, February 23, 2018
Time: 3:30 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 2472 H.D. 1, Relating to Low Income Housing Tax Credit

The Department supports the intent of this measure and provides the following comments regarding H.B. 2472, H.D. 1, for your consideration. Specifically, this measure:

- Eliminates conformity to the following Internal Revenue Code (IRC) sections such that these provisions do not apply to investments in buildings and projects claiming the credit:
  - Sections 42(k) and 465 - relating to the at-risk rules;
  - Section 469 – relating to the passive activity loss (PAL) limitations; and
  - Section 704-relating to partner's distributive share as it relates to State allocations; and
- Has a defective effective date of January 1, 2050 but otherwise and applies to qualified low-income buildings awarded credits after December 31, 2018.

First, the Department notes that it generally 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.

Second, there are two types of at-risk rules that this measure deletes: (1) IRC subsection 42(k), which relates to the credit basis of the building upon which the amount of the credit is calculated and (2) IRC section 465, which relates to the limit on deductions that can be taken based on an investment in an entity that owns a low income housing building.

Non-conformity to IRC section 42(k) may result in unintended consequences. Under current law, nonrecourse financing is added to the credit basis of the building only if the property was not acquired by the entity from a 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. The amount of the State credit is also set as 50% of the federal credits allocated. Nonconformity to IRC section 42(k) would allow a taxpayer to acquire the property from a related person at an inflated price using nonrecourse liability and increase the basis amount upon which the credit is calculated. To prevent this, the Department suggests that a new subsection (j)(3) be added as follows:

> <u>(3)</u> <u>In no event shall the amount of state credits allocated by the corporation for the qualified low income building exceed 50% of the amount of federal credits allocated to such building.</u>

Finally, the Department is able to implement the measure with its current effective date. 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
677 QUEEN STREET, SUITE 300
Honolulu, Hawaii 96813
FAX: (808) 587-0600

IN REPLY REFER TO:

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

HOUSE COMMITTEE ON FINANCE
February 23, 2018 at 3:30 p.m.
State Capitol, Room 308

In consideration of
H.B. 2472, H.D. 1
RELATING TO THE LOW-INCOME HOUSING TAX CREDIT.

The HHFDC ***supports*** H.B. 2472, H.D. 1. This bill proposes changes to the State Low-Income Housing Tax Credit (LIHTC) to increase the amount of equity generated by the sale of the LIHTC for affordable rental housing developments. We also support the Department of Taxation's proposed amendment to this bill, as referenced in the committee report.

This bill expands the pool of Hawaii taxpayers that can invest in the State LIHTC to any Hawaii taxpayer with Hawaii income tax liability. To increase the production of LIHTC projects, the result will be an increase in the supply of federal and State LIHTC. A federal LIHTC can be sold nationally, but a State LIHTC can only be sold to investors who owe Hawaii taxes. If we do not increase the number of Hawaii taxpayers who can invest in State LIHTCs, there will be an oversupply which will lower the price the existing pool of Hawaii LIHTC investors are willing to pay for a State LIHTC. Any increased pricing for the State LIHTC under this bill will generate more equity that can be spent on affordable rental housing development.

Thank you for the opportunity to testify.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Modify Low-Income Housing Credit

BILL NUMBER: HB 2472, HD-1

INTRODUCED BY: House Committee on Housing

EXECUTIVE SUMMARY: Seeks to make the State low-income housing credit more valuable by decoupling from the federal at-risk rules and passive activity loss limitations. As a policy matter, if it is considered desirable to offer incentives to develop such projects, consideration should be given to attacking the root causes of why such projects are prohibitively expensive, such as the permitting process.

SYNOPSIS: Amends HRS section 235-110.8 so that the federal at-risk rules under IRC section 42 and the federal passive activity limitations under IRC section 469 do not apply with respect to investments in buildings and projects claiming credit.

EFFECTIVE DATE: This Act shall take effect on July 1, 2050, and shall apply to qualified low-income buildings that receive an allocation of credits beginning after December 31, 2018; provided that the amendments made to section 235-110.8, Hawaii Revised Statutes, by section 1 of this Act shall not be repealed when that section is reenacted on December 31, 2021, pursuant to section 4 of Act 129, Session Laws of Hawaii 2016.

STAFF COMMENTS: Act 216, SLH 1988, adopted for Hawaii purposes the federal low-income rental housing credit that was part of the Tax Reform Act of 1986. The credit was enacted to offset the repeal of tax shelters and other incentives to build rental housing under prior law, such as accelerated depreciation, capital gains preference, certain tax-exempt bonds, and to specifically target low-income rentals.

While this is just one incentive to encourage developers to build affordable housing, consideration should be given to a number of strategies including the debt financing, partnerships with financial institutions who could then turn around and sell the credits, and the use of federal private activity bonds. Finally, one of the greatest contributors to the cost of housing in Hawaii is the draconian maze of permitting and regulatory processes required to bring those homes to market. While those regulatory guidelines are to insure the health and safety of the public, streamlining the process would accelerate the time needed to secure those permits thereby reducing the cost of financing. This savings would go a long way toward reducing the final cost of the house to the consumer.

Digested 2/21/2018

Testimony by InState Partners

In Support of HB2472 HD1
Relating to the Low-Income Housing Tax Credit
House Committee on Finance
Friday, February 23, 2018, 3:30PM; CR308

The Honorable Sylvia Luke, Chair and Committee Members:

My name is Rachel Stern, with InState Partners, testifying in support of HB2472 HD1 Relating to the Low-Income Housing Tax Credit.

The purpose of this bill is to build on the incentives provided under Act 129 (2016) by decoupling from the at-risk and passive activity loss limitations under federal income tax law. These federal tax limitations only permit large corporations to benefit from the credit, excluding most Hawaii individual and small businesses from participating. This bill therefore expands the investor pool to be more inclusive of the typical Hawaii investor.

InState Partners strongly supports this measure, and urges this committee to pass this measure out of committee. We also defer to the Hawaii Housing Finance and Development Corporation on the technical issues.

Thank you for this opportunity to testify.