

**DEPARTMENT OF BUSINESS,  
ECONOMIC DEVELOPMENT & TOURISM**

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Statement of  
**LUIS P. SALAVERIA**  
Director  
Department of Business, Economic Development and Tourism  
before the  
**HOUSE COMMITTEE ON FINANCE**  
Wednesday, February 28, 2018  
1:00 p.m.  
State Capitol, Conference Room 308

in consideration of  
**HB 2332, HD1**  
**RELATING TO THE LOW-INCOME HOUSING TAX CREDIT.**

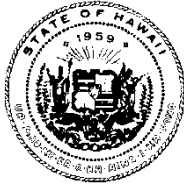
Chair Luke, Vice Chair Cullen, and Members of the Committee.

The Department of Business, Economic Development and Tourism (DBEDT)

**strongly supports** HB2332, HD1, an Administration bill.

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 by expanding the pool of potential investors. DBEDT supports this bill because it will improve the State LIHTC as a financing tool for affordable rental housing for low-income families at or below 60 percent of the area median income.

Thank you for the opportunity to offer support on HB2332, HD1.



**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 28, 2018 at 1:00 p.m.  
State Capitol, Room 308

In consideration of  
**H.B. 2332, H.D. 1**  
**RELATING TO THE LOW-INCOME HOUSING TAX CREDIT.**

The HHFDC supports H.B. 2332, H.D. 1 an Administration bill proposing 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.

By eliminating the applicability of the at-risk and passive activity loss limitations to State LIHTC investors, 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.



**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: Tuesday, February 28, 2018  
Time: 1:00 P.M.  
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: H.B. 2332, H.D. 1, Relating to the Low Income Housing Tax Credit

The Department of Taxation (Department) strongly supports H.B. 2332, H.D. 1, an Administration measure, defers to the Hawaii Housing Finance and Development Corporation (HHFDC) on the merits of this bill, and provides the following comments for your consideration. A summary of the key provisions of H.B. 2332, H.D. 1, is as follows:

- 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; and
  - Section 469 - relating to the passive activity loss (PAL) limitations;
- Has a defective effective date of January 1, 2050, but otherwise applies to qualified low-income buildings awarded credits after December 31, 2018; and
- Is repealed on December 31, 2021 by virtue of section 4 of Act 129, Session Laws of Hawaii 2016, which reenacts this section as it existed prior to the passage of Act 129, Session Laws of Hawaii 2016.

First, the Department the House Committee on Housing adopting its recommendation to add a provision that the State tax credits allocated to the building do not exceed 50% of the total federal tax credits allocated to the building.

Second, 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, 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.

Finally, the Department notes that it is able to implement the measure with its current effective date.

Thank you for the opportunity to provide testimony in support of this measure.

# 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 2332, 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, installment sale 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(k), the installment method rules under IRC section 453, the at-risk limitations under IRC section 465, and the passive activity limitations under IRC section 469, do not apply with respect to investments in buildings and projects claiming credit. However, all allocations to partners of their distributive shares of income, loss, and deductions under chapter 235 shall be made in proportion to the partner's allocation of credits.

EFFECTIVE DATE: January 1, 2050; applies to taxable years beginning after December 31, 2018.

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.

On the federal level, the tax credits and losses attributable to such a project are limited by a series of complex rules, including:

## At-Risk Rules

For individuals, estates, trusts, and closely held C corporations, deductions of business- or investment-related losses from an activity for a tax year are limited to the amount the taxpayer is at risk. The amount at risk includes: (1) the amount of money and the adjusted basis of property contributed to an activity; (2) amounts borrowed with respect to the activity to the extent the taxpayer is personally liable for repayment or has pledged property, other than property used in the activity, as security for the borrowed amount; and (3) generally, amounts borrowed with respect to the activity of holding real property for which no person is personally liable for repayment (qualified nonrecourse financing). The amount at risk is also increased by the excess of items of income from an activity for the tax year over items of deduction from the activity for the tax year.

Unlike a partner's tax basis, the amount at risk can go negative, although not from recognition of losses. The consequence of a negative at-risk amount is the potential for at-risk recapture, which is the recognition of previously deducted losses as income in a year in which a taxpayer's amount at risk is negative, often as the result of a distribution. Recognition of at-risk recapture increases a partner's amount at risk.

## Passive Activity Loss Rules

Passive activity loss rules are a set of IRS rules that prohibit using passive losses to offset earned or ordinary income. Passive activity loss rules prevent investors from using losses incurred from income-producing activities in which they are not materially involved.

Being materially involved with earned or ordinary income-producing activities means the income is active income and may not be reduced by passive losses. Passive losses can be used only to offset passive income.

The key issue with passive activity loss rules is material participation. According to IRS Topic No. 425, "material participation" is involvement in the operation of a trade or business activity on a "regular, continuous, and substantial basis." If the taxpayer does not materially participate in the activity that is producing the passive losses, then those losses can only be matched against passive income. If there is no passive income, then no loss can be deducted. However, rental activities, including real estate rental activities, are considered passive activities even if there is material participation ("real estate professionals" cannot benefit from this exception).

Passive activity losses can only be applied in the current year, and if they exceed passive income they can be carried forward without limitation; they cannot be carried back.

In general, passive activity loss rules are applied at the individual level, but they also extend to virtually all businesses and rental activity in various reporting entities, except C corporations, to deter abusive tax shelters.

## Installment Sale

In United States income tax law, an installment sale is generally a "disposition of property where at least 1 loan payment is to be received after the close of the taxable year in which the disposition occurs." The term "installment sale" does not include, however, a "dealer disposition" (as defined in the statute) or, generally, a sale of inventory.

The installment method of accounting provides an exception to the general principles of income recognition by allowing a taxpayer to defer the inclusion of income of amounts that are to be received from the disposition of certain types of property until payment in cash or cash equivalents is received.

The installment method defers the recognition of income when compared with both the cash and accrual methods of accounting. Under the cash method, the taxpayer would recognize the income when it is received, including the entire sum paid in the form of a negotiable note. The deferral advantages of the installment method are the most pronounced when comparing to the accrual

method, under which a taxpayer must recognize income as soon as he or she has a right to the income.

## Current Proposal

The proposal here is to make these rules inapplicable to investments in low-income housing projects. It is curious why installment sale rules are not to be applied, as they are generally favorable to taxpayers as opposed to the alternative, which would probably be accrual method recognition.

While this bill generally is just one incentive to encourage developers to build affordable housing, consideration should be given to many strategies including 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 2/26/2018



February 27, 2018

Hawaii State House of Representatives  
Committee on Finance  
Rep. Sylvia Luke, Chair  
Rep. Ty J.K. Cullen, Vice Chair  
State Capitol  
415 South Beretania Street  
Honolulu, Hawaii 96813

Hearing: February 28, 2018  
Time: 1:00PM, Room: 308  
Subject: HB 2332 HD1 Relating to Low Income Housing Tax Credits

### TESTIMONY IN SUPPORT

Chair Luke, Vice Chair Cullen and members of the Committee:

EAH Housing, as a developer and manager of Low Income Housing Tax Credit (LIHTC) properties, is in **strong support** of making the purchase of State LIHTCs available to a greater portion of our community which is the purpose of HB 2332 HD1.

With the reduction of the corporate tax rate from 35% to 21% our industry has seen a corresponding reduction in the purchase price of Federal LIHTCs. This reduction in pricing widens our financing gap and increases the pressure on our main source of local gap financing which is the State's Rental Housing Revolving Fund (RHRF).

Permitting a greater portion of our community to purchase State LIHTCs will hopefully increase the price of those credits thereby helping to reduce the demands on the RHRF. It is not a silver bullet to solve all our financing issues but will serve as another tool in our financing toolbox as we work to provide much needed affordable rental housing for our residents.

Thank you for allowing us to share our thoughts on this issue.

Sincerely,

Kevin R. Carney, (PB), NAHP-E, RB-16444  
Vice President, Hawaii  
EAH Housing, RB-16985



**HB-2332-HD-1**

Submitted on: 2/27/2018 12:47:59 PM

Testimony for FIN on 2/28/2018 1:00:00 PM

<b>Submitted By</b>	<b>Organization</b>	<b>Testifier Position</b>	<b>Present at Hearing</b>
Melodie Aduja	OCC Legislative Priorities Committee, Democratic Party of Hawai'i	Support	No

Comments:

Testimony by InState Partners

In Support of HB2332 HD1  
Relating to the Low-Income Housing Tax Credit  
House Committee on Finance  
Wednesday, February 28, 2018, 1:00PM; CR308

The Honorable Sylvia Luke, Chair and Committee Members:

My name is Rachel Stern, with InState Partners, testifying in support of HB2332 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.



**LATE**

February 28, 2018

Representative Sylvia J. Luke, Chair  
Representative Ty J.K. Cullen, Vice Chair  
House Committee on Finance

**Testimony in Support of HB 2332, HD1, Relating to the Low-Income Housing Tax Credit (Specifies that certain provisions of the Internal Revenue Code related to at-risk rules and deductions and to passive activity loss do not apply with respect to claims for the state low-income housing tax credit.)**

**Wednesday, February 28, 2018, 1:00 p.m., in Conference Room 308**

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.

LURF appreciates the opportunity to express its **support of HB 2330 H.D. 1.**

**HB 2332, HD1.** This bill specifies that certain provisions of the Internal Revenue Code related to at-risk rules and deductions and to passive activity loss do not apply with respect to claims for the State low-income housing tax credit (LIHTC).

**LURF's Position.** Under existing law and rules, the State's LIHTC is mostly used by large corporations or financial institutions and it is difficult for other Hawaii taxpayers to participate in LIHTCs. This limited pool of investors lowers demand, and, therefore, reduces the equity that can be generated, for each dollar of State LIHTC that is issued.

This measure is intended to further expand the pool of Hawaii taxpayers that would consider the State LIHTC to be an attractive investment by eliminating the applicability of the at risk and passive activity loss rules to the State LIHTC. This allows affordable rental housing developers to de—couple the State LIHTC from an ownership share in affordable rental project being financed, thereby allowing any Hawaii taxpayer with income tax liability to use the State LIHTC.

The State and proponents of this bill believe that by doing so, there will be an increased demand for the State LIHTC, and therefore, a corresponding increase in the dollar-per-dollar value of equity generated by the State LIHTC for the affordable rental housing project being developed.

Based on the above, LURF respectfully urges your favorable consideration of HB 2332, HD1.

Thank you for the opportunity to present testimony in support of this measure.

Please feel free to contact David Arakawa, LURF Executive Director, if there are any questions.