

DAVID Y. IGE
GOVERNOR



DENISE ISERI-MATSUBARA
INTERIM EXECUTIVE DIRECTOR

STATE OF HAWAII

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND TOURISM
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION
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IN REPLY REFER TO:

Statement of
DENISE ISERI-MATSUBARA
Hawaii Housing Finance and Development Corporation
Before the

SENATE COMMITTEE ON HOUSING

March 10, 2020 at 1:45 p.m.
State Capitol, Room 225

In consideration of
H.B. 2527, H.D. 1
RELATING TO THE LOW-INCOME HOUSING TAX CREDIT.

The HHFDC supports H.B. 2527, H.D. 1, with a requested amendment. 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.

Under existing law, large corporations or financial institutions with Hawaii income tax liability can purchase the State LIHTC. This relatively small pool of investors lowers the demand for the State LIHTC, and, therefore, the equity that can be generated for affordable rental housing projects through the sale of the State LIHTC. By eliminating the applicability of the at-risk and passive activity loss limitations to State LIHTC investors, this bill would expand the pool of Hawaii taxpayers that can invest in the State LIHTC and increase its the pricing, thereby generating more equity towards the affordable rental housing projects.

Based on discussions with the Department of Taxation, we respectfully request the following amendment be made to new subsection (j), which begins on page 7, line 14, through page 8, line 11 of the S.D. 1. Subsection (j) should be amended to read as follows (added language is highlighted):

(j) For a qualified low-income building that receives an allocation of credits after December 31, 2019:

- (1) Section 453 (with respect to the installment method), section 465 (with respect to deductions limited to amount at risk), and section 469 (with respect to passive activity losses and credits limited) of the Internal Revenue Code shall not be operative with respect to investments made in buildings and projects claiming the credit under this section; provided that this paragraph shall not apply to investments made in a buildings if such building ceases to be a qualified low-income building as defined under section 42(c) of the Internal Revenue Code;
- (2) 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 under this section;
- (3) In no event shall the amount of state credits allocated by the corporation for the qualified low-income building exceed fifty per cent of the amount of federal credits allocated to the building; and
- (4) The state depreciation basis of the qualified low-income building shall not exceed the federal depreciation basis of the building.

Thank you for the opportunity to testify.

DAVID Y. IGE
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RONA M. SUZUKI
DIRECTOR OF TAXATION
DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

To: The Honorable Stanley Chang, Chair;
The Honorable Dru Mamo Kanuha, Vice Chair;
and Members of the Senate Committee on Housing

From: Rona M. Suzuki, Director
Department of Taxation

Re: **H.B. 2527, H.D. 1, Relating to the Low-Income Housing Tax Credit**

Date: Tuesday, March 10, 2020

Time: 1:45 P.M.

Place: Conference Room 225, State Capitol

The Department of Taxation (Department) appreciates the intent of this measure, but **opposes four provisions in H.B. 2527, H.D. 1.**

H.B. 2527, H.D. 1, amends the low-income housing tax credit (LIHTC) to eliminate conformity to several Internal Revenue Code (IRC) sections:

- Sections 42(k) and 465 relating to the at-risk rules;
- Section 453 relating to the installment method;
- Section 469 relating to the passive activity loss (PAL) limitations; and
- Section 704 relating to partner's distributive share for state allocations. The Department notes that section 704 of the IRC already does not apply to the LIHTC through section 235-2.45(d)(e), Hawaii Revised Statutes.

H.B. 2527, H.D. 1, has a defective effective date of July 1, 2025 and otherwise applies to low-income buildings placed in service after December 31, 2020.

Two important provisions that were in the original version of this measure were deleted in H.D. 1. These provisions were intended to prevent abuse and unintended revenue losses for the State:

1. The first provision that was deleted was intended to disallow the special treatment proposed by this bill if a building ceases to be a qualified low-income building. To impose this limitation, the Department recommends **restoring the following clause to the end of paragraph (j)(1):**

provided that this paragraph shall not apply to investments made in a building if such building ceases to be a qualified low-income building as defined under section 42(c) of the Internal Revenue Code;

2. The second provision that was deleted was intended to prevent unintended consequences,

such as the inflation of the depreciable basis using nonrecourse financing, caused by the relaxation of at-risk and PAL rules. In order to prevent this, the Department suggests **restoring the following as a new paragraph (j)(4)**:

(4) The state depreciation basis of the qualified low-income building shall not exceed the federal depreciation basis of the building.

H.B. 2527, H.D. 1, extends the deadline that the LIHTC must be claimed from 12 months to 24 months. This would be the **only credit with a 2-year window to make claims**. It is unclear why this is needed.

H.B. 2527, H.D. 1, subsection (i) provides that the LIHTC, a nonrefundable credit, must be used to reduce tax liability first. This is a deviation from the general rule contained in section 235-91.5, HRS, which establishes that refundable credits are used to reduce tax liability before nonrefundable credits are applied. The Department **strongly recommends that the credit hierarchy established in section 235-91.5, HRS, be maintained for consistency in administration and fairness.**

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: INCOME, Low-Income Housing Credit, Passive Activity Loss and At-Risk Rules

BILL NUMBER: HB 2527, HD-1

INTRODUCED BY: House Committee on Housing

EXECUTIVE SUMMARY: Changes tax credit allocation for partnerships and corporations. Makes inoperative at risk and passive activity loss rules with respect to certain low-income housing projects. 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 section 235-110.8, HRS, to provide that the low-income housing tax credit may be allocated among the partners or members of the taxpayer earning the credit in any manner agreed to by such parties regardless of whether any such partner or member is deemed a partner for federal income tax purposes as long as the partner or member would be considered a partner for Hawaii state law purposes in accordance with section 425E-301, and may be claimed whether or not the taxpayer is eligible to be allocated a federal low-income housing tax credit pursuant to section 42 of the Internal Revenue Code. In addition, any allocation of a tax credit under this section may be made among the partners or members of a taxpayer in accordance with the immediately preceding sentence provided such partners or members have been admitted to the taxpayer in accordance with section 425E-301 on or prior to the date for filing the partner's or member's tax return (including any amendments thereto) with respect to the year of the tax credit.

Requires all claims for this credit to be filed on or before the end of the twenty-fourth month following the close of the taxable year for which the credit may be claimed. Failure to properly and timely claim the credit shall constitute a waiver of the right to claim the credit.

Requires the claimant to include a copy of form 8609 issued by the corporation with respect to the building; provided that if a taxpayer has not received form 8609 from the corporation with respect to its qualified low-income building at the time the taxpayer files its original tax return claiming the credits under this section, the taxpayer may later amend its tax return to include form 8609.

Amends section 235-110.8, HRS, to state that for any qualified low-income building that is placed in service after December 31, 2020:

(1) Section 453 (with respect to the installment method), section 465 (with respect to deductions limited to amount at risk), and section 469 (with respect to passive activity losses and credits limited) of the Internal Revenue Code shall not be operative with respect to investments made in buildings and projects claiming the credit under this section;

(2) All allocations to partners of their distributive shares of income, loss, and deductions under chapter 235 shall be made in accordance with the written agreement of the partners or members; and

(3) In no event shall the total amount of state credits allocated by the corporation for the qualified low-income building exceed fifty per cent of the amount of federal credits allocated to the building for the ten-year federal credit period.

EFFECTIVE DATE: July 1, 2025

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.

The proposal here is to make these rules inapplicable to investments in low-income housing projects.

While this is just one incentive to encourage developers to build affordable housing, consideration should be given to several 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 ensure 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 2/18/2020

HB-2527-HD-1

Submitted on: 3/9/2020 10:25:03 AM

Testimony for HOU on 3/10/2020 1:45:00 PM

Submitted By	Organization	Testifier Position	Present at Hearing
Galen Fox	Testifying for Faith Action	Support	No

Comments:

Faith Action supports HB 2527, which makes low-income housing tax credits (LIHTCs) more readily available in Hawaii. LIHTCs are key to expanding the production of low cost housing in Hawaii, creating homes our state's people badly need.



Hunt Companies, Inc.
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Senator Stanley Chang, Chair
Senator Dru Mamo Kanuha, Vice Chair
Committee on Housing

RE: **HB 2527 HD1 Relating to the Low-Income Housing Tax Credit – Support, Request Amendments**

March 10, 2020; 1:45 P.M.; conference room 225

Aloha Chair Chang, Vice Chair Kanuha and members of the committee:

Hunt Companies – Hawaii and Hunt Capital Partners, LLC supports HB 2527 HD1, which specifies that certain provisions of the Internal Revenue Code related to at-risk rules and deductions and passive activity loss do not apply to the state low-income housing tax credit (“LIHTC”) allocations after 12/31/2020, among other things.

HB 2527 HD1 will allow for the Hawaii low-income housing tax credit program to serve even more Hawaii residents at little to no additional cost to the State. This bill aims to expand the market of tax credit buyers and in turn, increase the price paid for these credits. A broader and more competitive marketplace for these tax credits will compel higher equity pricing and result in more affordable units in Hawaii.

We respectfully request your consideration of the following amendments:

- *Page 7, lines 14 to 15, “For a qualified low-income building placed in service under this section after **December 31, 2019**” and page 9, Section 3, line 9 ... “years beginning after **December 31, 2019**”*

This date is preferred to 12/31/2020 as it provides greater flexibility for projects completed this year.

- The changes to the code relating to the acceleration of the credit from 10 to 5 years, are set to expire December 31, 2021. **An extension of 5 additional years, to December 31, 2026**, would allow for adequate time to evaluate the effect of the changes on the supply of affordable housing in Hawaii.

Thank you for all your efforts to address Hawaii’s affordable housing crisis. We ask for your support in passing HB 2527 HD1 with our requested amendments.

Steven W. Colón
President – Hawaii Division

Jeff Weiss
President, Hunt Capital Partners, LLC



HAWAI' APPLESEED

CENTER FOR LAW & ECONOMIC JUSTICE

Testimony of Hawai'i Appleseed

Supporting HB2527 HD1 – Relating to Low-Income Housing Tax Credit

Senate Committee on Housing

Tuesday, March 10th, 2020, 1:45 PM, conference room 225

Dear Chair Chang and the Senate Committee on Housing,

Thank you for the opportunity to provide testimony **strongly supporting HB2527 HD1**. This bill is similar to SB2694 SD2, and would allow any Hawai'i taxpayer to purchase state low-income housing tax credits (LIHTC) instead of the few dozen which currently purchase Hawai'i LIHTC due to "at-risk" and "passive-activity loss" rules.

We urge the following amendments which would maximize the intent of this bill to enhance the state LIHTC program:

- 1) Make the new rules applicable to buildings placed in service after **December 31 2019** instead of December 31 2020. (SB2694 SD2 uses December 31st 2019).

Reason: Last year, a record amount of state LIHTC (over \$114M) was awarded to create over 1,600 new low-income housing units, thanks to \$200 million of funding for the Rental Housing Revolving Fund (RHRF) from the legislature in 2018. Some of those buildings will be placed in service **this year** and this change will allow any buildings placed in service in 2020 to take advantage of the new investor rules. Buildings placed in service this year could still be selling LIHTC in future years since the credit is taken over a five-year period. It would be prudent to include these buildings in the rule changes.

Tax Implications: There should be no adverse tax implications since any building placed in service in 2020, would be claiming the LIHTC credit on their tax return filed in 2021. Since these credits have already been awarded by the state, expanding the pool of potential buyers does not impact state revenues but it does impact the price that credits could sell for due to increased competition from more buyers.

Bill amendments:

SECTION 1, subsection j:

"For a qualified low-income building placed in service under this section after December 31, ~~2020~~. [2019]:

SECTION 3:

"This Act shall take effect on July 1st, 2025, and shall apply to low-income buildings placed in service in taxable years beginning after December 31st ~~2020~~;" [2019]

BILL DESCRIPTION: "~~..allocations after 12/31/2020~~" [2019]

- 2) **Extend Hawai'i LIHTC for another six years:** (similar to HB2261 HD1) Adding language to prevent the current Hawai'i LIHTC program from expiring at the end of next year, **December 31st 2021**, and instead extending the program another six years to end December 31st 2027.

Reason: To prevent a drop in the price of state LIHTC if the current rules which allow LIHTC to be used in a 5-year period instead of a 10-year period were to expire. In 2016, the legislature made state LIHTC more valuable and improved the price of the credits by allowing the credit to be used in five years instead of ten years. (Act 129, SL2016).

Investors are willing to pay more for a credit which can be used over five years, instead of ten years and it is estimated that this change helped improve the price of state LIHTC by about 10 cents per dollar of credit. For example, if an affordable housing developer was selling 100,000 worth of state LIHTC that must be spread out over 10 years a buyer might pay 60 cents per dollar of credit or \$60,000, but if the same credits could be used in 5 years they would pay 70 cents or \$70,000 for the credits. In this way, the state is receiving \$10,000 more dollars for affordable housing by increasing the value of the credit.

With more low-income rental projects being supported through federal and state tax credits, it is important to maintain the 5-year credit period and the value of LIHTC.

Bill Amendments: Similar to contents of HB2261 HD1.

Act 129, Session Laws of Hawaii 2016, section 4 is amended to read as follows:

“SECTION 4. This Act, upon its approval, shall take effect on January 1st, 2017, and shall apply to qualified low-income buildings awarded credits after December 31, 2016; provided that this Act shall be repealed on **December 31st ~~2021~~ 2027**”

Mahalo for the opportunity to testify.