DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR

ISAAC W. CHOY
DIRECTOR OF TAXATION

STATE OF HAWAII
DEPARTMENT OF TAXATION
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To: The Honorable Nadine K. Nakamura, Chair;
The Honorable Troy N. Hashimoto, Vice Chair;
and Members of the House Committee on Housing

From: Isaac W. Choy, Director
Department of Taxation

Date: February 9, 2021
Time: 10:00 A.M.
Place: Via Video Conference, State Capitol

Re: H.B. 80, Relating to Low-Income Housing Tax Credit

The Department of Taxation (Department) provides the following comments regarding H.B. 80 for your consideration.

H.B. 80 is effective upon approval and applies to qualified low-income buildings placed in service after December 31, 2019. The bill amends the Low-Income Housing Tax Credit (LIHTC) provided under Hawaii Revised Statutes (HRS) section 235-110.8 by:

- Allowing the LIHTC to be allocated among the partners or members of the taxpayer in any manner by the parties regardless of whether the partner or member is deemed to be a partner for federal income tax purposes;
- Extending the sunset date for the changes made by Act 129, Session Laws of Hawaii 2016, from December 31, 2021 to December 31, 2027;
- Allowing the LIHTC to be claimed for the first-year based on the carryover allocation letter or section 42(m) letter if Form 8609 has not been received by the taxpayer;
- Relaxing the installment method, at-risk, and passive activity loss rules for qualified low-income buildings placed in service after December 31, 2019; and
- Limiting the state depreciation to an amount equal to the federal basis.

The Department notes that it has concerns regarding the relaxation of the installment method, at-risk, and passive activity loss rules. The Department also notes that the relaxation of these rules applies to buildings placed in service after December 31, 2019. This date would allow retroactive special treatment and allow the special treatment to continue whether the building continues to be a qualified low-income building. In order to address these concerns, the Department suggests amending subsection (j) to read:

(j) For any qualified low-income building placed in service under this section 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 or members 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;

(3) The total amount of state credits allocated by the corporation for the qualified low-income building shall not exceed fifty per cent of the total amount of federal credits allocated to the building for the ten-year federal credit period; and

(4) The deductions and expenses claimed by all Hawaii taxpayers on Hawaii income tax returns shall not exceed the deductions and expenses claimed by all taxpayers on federal returns.

Provided that this subsection shall not apply to any building that ceases to be a qualified low-income building.

This proposed language includes a modification to paragraph (j)(4). After closer examination, the Department determined that the language in paragraph (j)(4) did not have the desired effect of limiting the state deductions. The language following paragraph (j)(4) is also important in that it revokes the exemption from at-risk and passive activity loss rules if the building ceases to be a qualified low-income building. Without this provision, the building could continue to receive this special tax treatment even if it fell out of compliance a year after qualifying.

Finally, the Department recommends that Section 4 of the bill be amended to apply the Act to buildings placed in service after December 31, 2020 rather than after December 31, 2019. As explained above, applying this measure to buildings placed in service after December 31, 2019 would allow retroactive application of the special treatment allowed by this measure.

Thank you for the opportunity to provide comments.

DAVID Y. IGE
GOVERNOR

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

HOUSE COMMITTEE ON HOUSING
February 9, 2021 at 10:00 a.m.
State Capitol, Room 423

In consideration of
H.B. 80
RELATING TO THE LOW-INCOME HOUSING TAX CREDIT.

The HHFDC ***offers the following comments*** on H.B. 80. The measure in part seeks to amend the income tax law with respect to the State Low-Income Housing Tax Credit (LIHTC). HHFDC generally supports efforts to maximize the value of the State LIHTC because that would make affordable rental housing development more feasible to build. However, we defer to the Department of Taxation as to whether the changes take the State LIHTC further away from the Federal LIHTC provisions of the Internal Revenue Code, particularly for enforcement and monitoring purposes.

The bill also extends the sunset date of amendments to the State LIHTC made in Act 129, SLH 2016 to December 31, 2027. HHFDC supports this provision. Act 129, SLH 2016, amended the calculation of the State LIHTC by amending the applicable period over which the credit may be claimed from ten to five years to increase the attractiveness of the State LIHTC, and generate more equity to finance affordable rental housing development. Act 129 currently has a sunset date of December 31, 2021.

Thank you for the opportunity to testify.

Michaels

DEVELOPMENT
FINANCE
MANAGEMENT
CONSTRUCTION

Testimony of The Michaels Organization | Michaels Development - Hawai`i Region
RELATING TO House Bill No. 80

Tuesday, February 9, 2021 at 10:00 a.m.
Conference Room 423

COMMITTEE ON HOUSING
Rep. Nadine K. Nakamura, Chair; Rep. Troy N. Hashimoto, Vice Chair; Rep. Henry J.C. Aquino
Rep. Lisa Kitagawa, Rep. Lynn DeCoite, Rep. Roy M. Takumi, Rep. Greggor Ilagan, and
Rep. Bob McDermott; Members

Support

The intent of this bill is to expand the pool of state tax credit investors, which will allow for a more competitive marketplace, thus resulting in increased tax credit pricing and total equity available to be invested in affordable housing projects. This will have the added benefit of reducing the need for gap financing from the state Rental Housing Revolving Fund (RHRF).

Additionally, this bill extends the sunset date of the hugely successful temporary state low-income housing tax credit finance tool created by Act 129, Session Law of Hawaii 2016 to December 31, 2027.

Thank you for the opportunity to provide comments in **support** of House Bill 80.

Karen Seddon

Karen Seddon
Regional Vice President
Michaels Development – Hawai`i Region

Pacific Guardian Center – Mauka Tower
737 Bishop Street, Suite 2020
Honolulu, Hawaii 96813
(808) 691-9446

TAX FOUNDATION OF HAWAII

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

SUBJECT: INCOME, Low-Income Housing Credit, Allocations

BILL NUMBER: HB 80

INTRODUCED BY: NAKAMURA, AQUINO, BELATTI, DECOITE, GATES, HAR, HASHIMOTO, HOLT, ICHIYAMA, ILAGAN, JOHANSON, KITAGAWA, B. KOBAYASHI, LOWEN, MATAYOSHI, MCKELVEY, MIZUNO, MORIKAWA, NAKASHIMA, PERRUSO, QUINLAN, TAKAYAMA, TAM, TARNAS, WILDBERGER, LoPresti, Marten, Sayama

EXECUTIVE SUMMARY: Clarifies when and how members or partners of a taxpayer may claim the low-income housing tax credit. Requires a Form 8609 for purposes of claiming the tax credit. Specifies the application of tax provisions with respect to buildings or projects in service in 2020 and later. Extends the sunset date of Act 129, Session Laws of Hawaii 2016, to 12/31/2027.

EXECUTIVE SUMMARY: Allows the low income housing tax credit to be allocated among the partners or members of the taxpayer earning the credit in any manner by the parties. Extends increases made to the low income housing tax credit from 12/31/21 to 12/31/27.

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, so long as the partner or member would be considered a partner pursuant to section 425E-301, HRS, 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 applicable state law 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 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;

(3) The total amount of state credits allocated by the corporation for the qualified low-income building shall not exceed fifty per cent of the amount of federal credits allocated to the building for the ten-year federal credit period; and

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

EFFECTIVE DATE: Applies to qualified low-income housing buildings placed in service in taxable years beginning after December 31, 2019.

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.

Technical Concern and Concluding Comments

The references in this bill to the Hawaii partnership statute in chapter 425E, HRS, could raise a concern because if qualification of the bill is limited to partnerships organized in Hawaii as opposed to other jurisdictions, the limitation may be seen as discrimination against interstate commerce which would violate the Commerce Clause of the U.S. Constitution. Other bills (SB 359 / HB 378) seem to have tackled this problem.

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 2/5/2021

Hunt Companies, Inc.
737 Bishop St., Suite 2750
Honolulu, HI 96813
808-585-7900

Representative Nadine Nakamura, Chair
Representative Troy Hashimoto, Vice Chair
Committee on Housing

RE: **HB 80 Relating to the Low-Income Housing Tax Credit – In Strong Support**
Tuesday, February 9, 2021; 10:00 AM; via Videoconference

Aloha Chair Nakamura, Vice Chair Hashimoto and members of the committee:

Hunt Companies – Hawaii and Hunt Capital Partners LLC appreciate this opportunity to submit testimony in strong support of HB 80, which clarifies when and how members or partners of a taxpayer may claim the low-income housing tax credit, requires a Form 8609 for purposes of claiming the tax credit and specifies the application of tax provisions with respect to buildings or projects in service in 2020 and later. It also extends the sunset date of Act 129, Session Laws of Hawaii 2016, to 12/31/2027.

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:

Section 1 (b) on page 2 – add “member” to “partner” references because some entities are limited liability companies rather than partnerships, and replace “pursuant to section 425E-301” with “pursuant to applicable state law” as not all entities will be formed under Hawaii state law. Many tax credit syndicators form their entities under their own local state law. As long as a taxpayer is considered to be a partner or member under the state law governing the entity in which the taxpayer is a partner or member, the taxpayer is permitted to be allocated the Hawaii low-income housing tax credit.

Thank you for all your efforts to address Hawaii’s affordable housing crisis. We ask for your favorable consideration in passing HB 80 with our requested amendments.

Steven W. Colón
President – Hawaii Division

Jeff Weiss
President, Hunt Capital Partners, LLC

SUGAR CREEK CAPITAL
A forward approach.
17 West Lockwood Avenue
St. Louis, MO 63119
p: 314-968-2205

Testimony of Sugar Creek Capital

House Committee on Housing

Tuesday, February 9, 2021
10:00 a.m.
State Capitol, Conference Room 423

On the following measure:
H.B. 80, RELATING TO THE LOW-INCOME HOUSING TAX CREDIT

Aloha Chair Nakamura, Vice-Chair Hashimoto and Members of the Committee:

Sugar Creek Capital specializes in state low-income housing tax credit investments that benefit working families and fixed-income seniors across the state and the country.

Sugar Creek Capital testifies in support of HB 80 <u>with amendments.</u>

Key Points about LIHTC:

- Hawaii's state affordable housing tax credit is a long-standing, proven tool that allows for thousands of Hawaii residents to live with dignity.

- The proposed measures in HB 80 will allow for this program to serve even more Hawaii residents at <u>little to no cost to the state</u>.

- Affordable housing developers use Hawaii tax credits to raise equity from investors. With these tax credit equity investments, rents in these units stay well below market rate rents far into the future.

- Affordable housing tax credit investors sell these credits to Hawaii taxpayers who then in turn use them to offset their tax liability.

SUGAR CREEK CAPITAL
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p: 314-968-2205

Proposed Amendments:

- Page 2, (b), line : inserting "the" before "individual"

- Page 2, (b), line 5: inserting "or member" after "partner" and changing "section 425E-301" to "applicable state law"

- Page 2, (b), line 9: inserting "or member" after "partner"

- Page 2, (b), line 10: amending "section 425E-301" to "applicable state law"

- Page 2, (b), line 12: amending "section 425E-301" to "applicable state law"

- Page 8, (j), lines 1-2, replacing “a low-income building placed in service under this section” with “taxable years” and changing "2019" to "2020"

- Page 10, Section 4, lines 6-8: striking “qualified low-income buildings placed in service in” and changing "2019" to "2020”

We respectfully request this Committee pass HB 80 out with the proposed amendments so we can continue to address the incredible housing need in Hawaii.

Mahalo for the opportunity to provide testimony.

LATE

STANFORD CARR DEVELOPMENT, LLC

February 9, 2021

The Honorable Nadine Nakamura, Chair and Committee Members
Committee on Housing
State House of Representatives
State Capitol, Rm. 423
Honolulu, HI 96813

RE: HB 80 Relating to the Low-Income Housing Tax Credit
HB 908 relating to the Low-Income Housing Tax Credit

Dear Chair Nakamura and Members:

My name is Stanford S. Carr and I strongly support HB 80 Relating to the Low-Income Housing Tax Credit, which clarifies when and how a taxpayer(s) may claim the low-income tax credits and HB 908 Relating to the Low-Income Housing Tax Credit. In particular, the measure clearly outlines the process that must be used to claim the low-income tax credits. HB 80 further clarifies a process that will be used by HHFDC to claim the credit, by issuing a form that states the amount of credit that the available and may be claimed and HB 908 extends the repeal of Act 129 (2016) to December 31, 2026.

We believe that HB 80 will help investors in claiming the credit. The measure provides a check and balance mechanism that regulates who and when the low-income tax credit may be taken, and is a good step towards providing more investors an opportunity to participate in the State's low-income housing tax credit program.

We also believe that with HB 908, extending the repeal date from December 31, 2021 to December 31, 2026, creates more opportunity to build affordable housing, which is desperately needed.

We strongly support both HB 80 and HB 908 Relating to Low-Income Affordable Housing.

Thank you for this opportunity to testify.

Stanford S. Carr

ALAKEA CORPORATE TOWER • 1100 ALAKEA STREET, 27TH FLOOR • HONOLULU, HAWAII 96813
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LATE

TO: The Honorable Nadine K. Nakamura, Chair
House Committee on Housing

The Honorable Troy N. Hashimoto, Vice Chair
House Committee Housing

FROM: Alana K. Pakkala

SUBJECT: HEARING OF FEBRUARY 9, 2021; TESTIMONY IN SUPPORT OF HB 80 RELATING TO LOW INCOME HOUSING TAX CREDIT

Thank you for the opportunity to submit testimony in **support** of this important measure. The allocation and eligibility of low income housing tax credit will allow for expansion of help from those who are able to support the need of Hawaii's affordable housing shortage. This bill will help to incentivize investors to participate in the development of affordable housing within the state and therefore help to address the affordable housing crisis, especially during this economic downturn.

I commend the legislature for recognizing measures needed to be undertaken to alleviate our state's need of affordable housing.