

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
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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

February 4, 2021 at 1:00 p.m.
State Capitol, Room 225

In consideration of
S.B. 659
RELATING TO AFFORDABLE HOUSING.

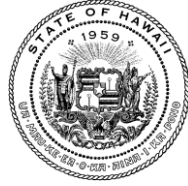
The HHFDC ***offers the following comments*** on S.B. 659. The measure in part seeks to amend the income tax law with respect to the State Low-Income Housing Tax Credit (LIHTC). HHFDC generally supports efforts to maximize the value of the State LIHTC because that would make affordable rental housing development more feasible to build. However, we defer to the Department of Taxation as to whether the changes made to the State LIHTC are acceptable.

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.

DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR



ISAAC W. CHOY
DIRECTOR OF TAXATION

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

From: Isaac W. Choy, Director
Department of Taxation

Date: February 4, 2021
Time: 1:00 P.M.
Place: Via Video Conference, State Capitol

Re: S.B. 659, Relating to Low-Income Housing Tax Credit

The Department of Taxation (Department) provides the following comments regarding S.B. 659 for your consideration.

S.B. 659 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, 2020; 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, 2020 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.

Thank you for the opportunity to provide comments.



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

Senator Stanley Chang, Chair
Senator Dru Mamo Kanuha, Vice Chair
Committee on Housing

RE: **SB 659 Relating to Low-Income Housing Tax Credit – In Support**
Thursday, February 4, 2021; 1:00 PM; conference room 225

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

Hunt Companies – Hawaii and Hunt Capital Partners LLC appreciate this opportunity to submit testimony in strong support of SB 659, which 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 and extends increases made to the low-income housing tax credit from 12/31/21 to 12/31/27.

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 1, line 12; restore “a net”

Page 8, (j) lines 3-4; replace “for any qualified low-income building placed in service under this section after December 31, 2020” with “for taxable years after December 31, 2020”

The above amendment should make it administratively easier for the Department of Taxation to apply the statutory changes on a taxable year basis. The provisions will apply to all claims for tax credits for the taxable year.

Thank you for all your efforts to address Hawaii’s affordable housing crisis. We ask for your support in passing SB 659 with our requested amendments.

Steven W. Colón
President – Hawaii Division

Jeff Weiss
President, Hunt Capital Partners, LLC

TAX FOUNDATION OF HAWAII

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SUBJECT: INCOME, Low-Income Housing Credit, Allocations

BILL NUMBER: SB 659; HB 378

INTRODUCED BY: SB by KEITH-AGARAN, ENGLISH, KIDANI, Wakai; HB by SAIKI

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 as long as the partner or member would be considered a partner for applicable state law purposes, 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: Taxable years beginning after December 31, 2020.

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 2/1/2021

Testimony of Sugar Creek Capital

Senate Committee on Housing

**Thursday, February 4, 2021
1:00 p.m.**

State Capitol, Conference Room 225

On the following measure:

S.B. 659, RELATING TO THE LOW-INCOME HOUSING TAX CREDIT

Aloha Chair Chang, Vice-Chair Kanuha 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 SB 659 with amendments.

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 SB 659 will allow for this program to serve even more Hawaii residents at little to no cost to the state.
- 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.

We offer the proposed amendments for consideration:

- Page 1, (b), line 12: restore “a net” instead of “an”

- Page 2, (b), lines 1 – 11: revise to read “credit under this section may be allocated by the entity in any manner agreed to by the parties regardless of whether the individual or entity to receive the credit is deemed to be a partner for federal income tax purposes, so long as the individual or entity is deemed to be a partner or member pursuant to applicable state law. The credit 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. For individuals or entities that are deemed to be a partner or member of the taxpayer pursuant to applicable state law, those individuals or entities shall have been admitted to the taxpayer pursuant to applicable state law, on or prior to the date of filing their respective tax return, including any amendments thereto, with respect to the year of the tax credit.”

- Page 7, (i), line 6: strike “provided further that” and replace with “and”; insert “the taxpayer shall”

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- Page 7, (i), line 7: delete the phrase “the taxpayer shall” and change “the” to “its”
- Page 7, (i), line 10: delete the phrase “the taxpayer shall”
- Page 8, (j), lines 3-4, replacing “any qualified low-income building placed in service under this section” with “taxable years”
- Page 8, (j), line 15: insert “In no event shall” before “the”
- Page 8, (j), line 17: strike “shall not”
- Page 10, Section 2, line 1: strike “and placed in service on or before December 31, 2019”
- Page 10, Section 4, line 15: strike “as amended by” and replace with “and”

We respectfully request this Committee pass SB 659 out with the proposed amendments, so we can continue to address the incredible housing need in Hawaii.

Mahalo for the opportunity to provide testimony.