DEPARTMENT OF TAXATION
2022 Fiscal Impact Statement

1. **Patron** Mamie E. Locke
2. **Bill Number** SB 47
   House of Origin:
   _____ **Introduced**
   __X__ **Substitute**
   _____ **Engrossed**

   Second House:
   _____ **In Committee**
   _____ **Substitute**
   _____ **Enrolled**
3. **Committee** Senate Finance and Appropriations
4. **Title** Enhancement of the Virginia Housing Opportunity Tax Credit and Establishment of a New Transferable Virginia Housing Opportunity Tax Credit

5. **Summary/Purpose:**

The Department of Taxation ("the Department") understands that the Patron intends on introducing a substitute for this bill. This fiscal impact statement is based on the substitute.

This bill would modify Virginia's existing Housing Opportunity Tax Credit and establish a new Transferable Virginia Housing Opportunity Tax Credit.

Modifications to Virginia's Existing Housing Opportunity Tax Credit

This bill would permit the Virginia Housing Development Authority ("VHDA") to reserve Virginia Housing Opportunity Tax Credits with respect to certain low-income building projects that newly qualify for the credit in a given fiscal year or other 12-month period designated by the VHDA. The amount of credits that VHDA would be permitted to reserve with respect to such projects would be limited to $150 million (i.e., $15 million for each year of the 10-year credit period) plus:

- The amount, if any, by which the $150 million reservation cap for the preceding fiscal year or other 12-month period exceeds the tax credits awarded by the VHDA in that year or 12-month period; and

- The amount of tax credits recaptured or otherwise disallowed in the preceding fiscal year.

Each annual group of new qualified low-income building projects would be eligible to receive a separate reservation of credits of $150 million plus any additions as described above. The $150 million per fiscal year or 12-month period reservation cap would replace the $15 million per calendar year cap imposed by current law.

This portion of the bill would be effective for fiscal years or other 12-month period designated by the VHDA beginning on and after January 1, 2021, but before July 1, 2025.

Transferable Virginia Housing Opportunity Tax Credit

This bill would establish a new Transferable Virginia Housing Opportunity Tax Credit for the benefit of the owner of a low-income building project. The project would be required to be located in Virginia, placed in service on or after January 1, 2023, and issued an eligibility certificate. The amount of credits that VHDA would be permitted to reserve with respect to such projects would be limited to $50 million plus the amount, if any, by which the $50 million reservation cap for the preceding fiscal year or other 12-month period exceeds the transferable tax credits awarded by the VHDA in that year or 12-month period.

This portion of the bill would be effective for fiscal years or other 12-month period designated by the VHDA beginning on and after January 1, 2022, but before July 1, 2025. However, this bill would provide that a taxpayer may claim the Transferable Virginia Housing Opportunity Tax Credit for taxable years beginning on and after January 1, 2023.

6. **Budget amendment necessary:** Yes.
   Item(s): Page 1, Revenue Estimates
   274 and 276, Department of Taxation

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)
   7a. Expenditure Impact:

Fiscal Year	*Dollars*	*Positions*	*Fund*
2022-23	$237,655	1	GF
2023-24	$70,200	1	GF
2024-25	$70,200	1	GF
2025-26	$70,200	1	GF
2026-27	$70,200	1	GF
2027-28	$70,200	1	GF

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation ("the Department") would incur administrative costs of $237,655 in Fiscal Year 2023 and $70,200 in Fiscal Year 2024 and each fiscal year thereafter. These costs include hiring one full-time employee to administer the tax credit transfer process, as well as the costs of updating the Department's forms and systems to process the credit transfers as set forth in this bill.

The VHDA states that any costs that it may incur would have no state budgetary impact, as it is permitted by law to charge fees to developers to cover any costs. In addition, VHDA is self-supporting and does not receive state appropriations.

Revenue Impact

This bill would result in a significant unknown negative General Fund revenue impact. The overall impact of the combined credit program could be up to $200 million annually in later years. The initial impact would begin in Fiscal Year 2023, and the extent to which taxpayers with qualified projects would apply for and claim the credit provided by this bill is unknown. Because this bill would authorize a $150 million reservation cap on the existing credit program as well as a new transferable credit capped at $50 million annually, the negative General Fund revenue impact would generally be limited to $25 million in Fiscal Year 2023; $65 million in Fiscal Year 2024; $80 million in Fiscal Year 2025; $95 million in Fiscal Year 2026; $110 million in Fiscal Year 2027; and $125 million in Fiscal Year 2028. These amounts do not account for additional credits that may be added or credits that are not utilized by taxpayers, which could further increase the negative revenue impact in those years.

Modifications to Virginia's Existing Housing Opportunity Tax Credit

This portion of the bill would result in a significant unknown negative General Fund revenue impact beginning in Fiscal Year 2024. Under this portion of the bill, there would be an annual reservation cap for new projects of $150 million plus any additions as permitted in the bill. Each annual group of new qualified low-income building projects would be eligible to receive a separate reservation of credits of $150 million plus any additions. However, taxpayers would claim reserved credits on their tax return over a 10-year period subject to certain limitations specified by the bill.

In addition, because this portion of the bill would provide a unique reservation of credits for each annual group of new qualified low-income building projects, credit claims would be permitted to stack together. This may work to ultimately increase the revenue impact of this portion of the bill by $15 million each fiscal year after Fiscal Year 2024 until either:

- A $75 million per fiscal year maximum revenue impact is reached if the sunset date of this bill is not subsequently extended; or
- A $150 million per fiscal year maximum revenue impact is reached if the sunset date of this bill is subsequently extended.

For example, if the reservation of credits is limited to $150 million per fiscal year, the negative revenue impact of this portion of the bill would generally be limited to $15 million in Fiscal Year 2024; $30 million in Fiscal Year 2025; $45 million in Fiscal Year 2026; $60 million in Fiscal Year 2027; and $75 million in Fiscal Year 2028. However, this does not account for additional credits that may be added or credits that are not utilized by taxpayers, which could further increase the negative revenue impact in those years.

Transferable Virginia Housing Opportunity Tax Credit

This portion of the bill would result in a significant unknown negative General Fund revenue impact beginning in Fiscal Year 2023. Under this portion of the bill, there would be an annual reservation cap for new projects of $50 million plus any additions as permitted in the bill. However, unlike with this bill's provisions regarding Virginia's existing Housing Opportunity Tax Credit, there is no provision of this bill that would require taxpayers to claim the transferable credit ratably over a credit period. As a result, it is expected that most taxpayers, to the extent permitted by VHDA, would claim all $50 million during the first year in the credit period and not claim any amount in the second year of the transferable credit's two-year credit period. Therefore, this portion of the bill would generally result in annual negative General Fund revenue impact of up to $50 million. However, this does not account for additional credits that may be added, which could further increase the negative revenue impact in those years.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia Housing Development Authority

10. Technical amendment necessary: Yes.

As currently drafted, the $150 reservation cap under this bill would be increased by the amount of tax credits recaptured or otherwise disallowed in the preceding fiscal year. This recapture and disallowance language would not address the situation where VHDA chooses to use a 12-month period other than a fiscal year, as allowed by this bill. In addition, it is unclear how this aggregate recapture and disallowance amount would be determined. To the extent it is determined based on tax returns filed with the Department reporting recapture and/or credit disallowance, then it would vary depending on when taxpayers choose to file their returns or amended returns, among other factors, and it would be unclear how the aggregate recapture amount could be accurately determined. In addition, even if this amount could be determined, there may be confidentiality issues because state law generally prohibits the Department from sharing confidential taxpayer information.

As currently drafted, this bill would authorize the VHDA to promulgate regulations and guidelines as necessary to administer the new Transferable Virginia Housing Opportunity Tax Credit that this bill would provide. This bill would require the Department to administer and track the transferability portion of this credit. However, it would not grant the Department similar authority, or require VHDA to consult with the Department in the development of any regulations and guidelines VHDA promulgates with respect to this credit program. Because of the requirements that this bill would impose on the Department with respect to the transferability portion of this credit, the Department recommends a technical amendment that would require VHDA to consult with the Department in developing any regulations or guidelines regarding this credit.

11. Other comments:

Federal Low-Income Housing Tax Credit

The federal low-income housing tax credit ("LIHTC") is a nonrefundable income tax credit that was created by the Tax Reform Act of 1986 to provide an incentive for the development and rehabilitation of affordable rental housing. LIHTCs are awarded to developers of qualified rental projects via a competitive application process administered by state housing finance authorities. Typically, developers will effectively "sell" their tax credits to outside investors by entering into limited partnerships or limited liability companies with investors, with 99.99 percent of the profits, losses, depreciation, and tax credits being allocated to the investors as a partner in the partnership or member in the limited liability company. This reduces the debt developers would otherwise have to incur and the equity they would otherwise have to contribute. With lower financing costs, tax credit properties can potentially offer lower, more affordable rents.

Two types of LIHTCs are available depending on the nature of the construction project. The so-called 9 percent credit is generally reserved for new construction, while the so-called 4 percent credit is typically used for rehabilitation projects and new construction that is financed with tax-exempt bonds. Each year, for ten years, a tax credit equal to roughly 4 percent or 9 percent of a project's qualified basis (cost of construction) is claimed. The applicable credit rates have historically not actually been 4 percent and 9 percent. Instead, the credit rates have fluctuated in response to market interest movements so that the program has delivered a subsidy equal to 30 percent of the present value of a project's qualified basis in the case of the 4 percent credit, and 70 percent in the case of the 9 percent credit. For both the 4 percent and 9 percent credit it is the subsidy levels (30 percent or 70 percent) that are explicitly specified under federal tax law, not the credit rates. Since 1986, the 4 percent rate has ranged between 3.15 percent and 3.97 percent, and the 9 percent credit between 7.35 percent and 9.27 percent. Since 2008, however, there has been a floor under the 9 percent credit below which the new construction credit rate cannot fall.

The process of allocating, awarding, and then claiming the LIHTC is complex and lengthy. The process begins at the federal level with each state receiving an annual LIHTC allocation in accordance with federal law. State housing agencies then allocate credits to developers of rental housing according to federally required, but state created, allocation plans. The process typically ends with developers effectively selling allocated credits to outside investors in exchange for equity.

<u>Taskforce and Report to Study Establishment of Virginia Credit</u>

During the 2020 General Assembly Session, House Bill 810 was enacted, which required the Department of Housing and Community Development ("DHCD") and the Virginia Housing Development Authority ("VHDA") to convene a stakeholder advisory group ("Task Force") to:

- Determine the most effective and efficient way to administer a Virginia housing opportunity tax credit program,
- Develop draft legislation establishing such an affordable housing credit program, and
- Conduct financial modeling to determine the fiscal impact of such a program to Virginia.

Such legislation also required the Task Force to report its recommendations to the Governor, the Secretary of Commerce and Trade, the Director of the DHCD, and the commissioners of the VHDA by September 1, 2020. Such report, the Report of the Virginia Housing Opportunity Tax Credit Task Force, was published in September 2020.

<u>Virginia Housing Opportunity Tax Credit</u>

As a result of this taskforce and report, during 2021 Special Session I, the General Assembly enacted legislation to establish the Virginia Housing Opportunity Tax Credit for certain low-income building projects. The amount of such credit is substantially similar to the amount of federal LIHTC allocated or allowed by VHDA to such projects. The credit is allowed for each project for each year of the federal credit period, in an amount equal to the amount of federal LIHTC allocated or allowed by VHDA to such project. Therefore, for each qualified project, the credit is allowable for up to ten, consecutive taxable years beginning with the date a building is placed in service or the following year, at the election of the taxpayer. However, there is no reduction in the tax credit allowable in the first year of the credit period due to a calculation based on qualified occupancy under federal tax law.

The credit is subject to a $15 million annual credit cap. To be qualified, the project must be a qualified low-income building, as defined under federal law, that is:

- Located in Virginia;
- Placed in service on or after January 1, 2021; and
- Issued an eligibility certificate.

If a portion of any federal low-income housing credits taken on a qualified project is required to be recaptured or is otherwise disallowed during the credit period, the taxpayer claiming Virginia Housing Opportunity Tax Credit with respect to such project must recapture a portion of such credits. The percentage of credits subject to recapture is equal to the percentage of federal low-income housing credits subject to recapture or otherwise disallowed during such period. Any tax credits recaptured or disallowed will increase the income tax liability of the qualified taxpayer who claimed the tax credits in a like amount and must be included on the tax return of the taxpayer submitted for the taxable year in which the recapture or disallowance event is identified.

VHDA is required to administer the Virginia Housing Opportunity Tax Credit program and is authorized to promulgate the regulations and guidelines necessary to implement and administer it. Such regulations and guidelines may include the imposition of application, allocation, certification, and monitoring fees designed to recoup the costs of VHDA in administering the program. VHDA may also promulgate regulations and guidelines in consultation with the Department to allow a qualified project to elect in its application to the VHDA to sell all or any portion of its credits awarded to one or more unrelated taxpayers. Regulations and guidelines regarding the sale of credits, if promulgated, may not be allowed to take effect prior to January 1, 2023, and may not apply to credits awarded prior to January 1, 2023.

<u>Sunset Dates for New Income Tax Credits and Sales Tax Exemptions</u>

Section 3-5.14 of the 2021 Appropriation Act provides that any new sales tax exemption or tax credit enacted by the General Assembly after the 2019 Session, but prior to the 2024 Session, must have a sunset date of not later than June 30, 2025.

<u>Proposed Legislation</u>

This bill would modify Virginia's existing Housing Opportunity Tax Credit and establish a new Transferable Virginia Housing Opportunity Tax Credit.

Modifications to Virginia's Existing Housing Opportunity Tax Credit

This bill would permit the Virginia Housing Development Authority ("VHDA") to reserve Virginia Housing Opportunity Tax Credits with respect to certain low-income building projects that newly qualify for the credit in a given fiscal year or other 12-month period designated by the VHDA. The amount of credits that VHDA would be permitted to reserve with respect to such projects would be limited to $150 million (i.e., $15 million for each year of the 10-year credit period) plus:

- The amount, if any, by which the $150 million reservation cap for the preceding fiscal year or other 12-month period exceeds the tax credits awarded by the VHDA in that year or 12-month period; and

- The amount of tax credits recaptured or otherwise disallowed in the preceding fiscal year.

Each annual group of new qualified low-income building projects would be eligible to receive a separate reservation of credits of $150 million plus any additions as described above. The $150 million per fiscal year or 12-month period reservation cap would replace the $15 million per calendar year cap imposed by current law.

The Housing Opportunity Tax Credit would be in an amount determined by the VHDA to be necessary for the financial feasibility of the qualified project and consistent with the VHDA's qualified allocation plan but would not be allowed to be less than fifty percent of the annual amount of the federal credit approved for such project if the approved annual federal credit amount is equal to or less than $1.5 million, and would not be permitted to be less than twenty-five percent of the annual amount of the federal credit approved for such project if the approved annual federal credit amount is greater than $1.5 million. The VHDA would be required to send written notice of the award to the owner of the project. The award notice would be required to state the amount of Housing Opportunity Tax Credit awarded for each year of the project's ten-year credit period and stipulate that receipt of the tax credit is contingent upon issuance of an eligibility certificate.

This portion of the bill would be effective for fiscal years or other 12-month period designated by the VHDA beginning on and after January 1, 2021, but before July 1, 2025.

Transferable Virginia Housing Opportunity Tax Credit

This bill would establish a new Transferable Virginia Housing Opportunity Tax Credit for the benefit of the owner of a low-income building project. The project would be required to be located in Virginia, placed in service on or after January 1, 2023, and issued an eligibility certificate. The amount of credits that VHDA would be permitted to reserve with respect to such projects would be limited to $50 million plus the amount, if any, by which the $50 million reservation cap for the preceding fiscal year or other 12-month period exceeds the transferable tax credits awarded by the VHDA in that year or 12-month period.

The Transferable Virginia Housing Opportunity Tax Credit would be awarded in an amount determined by VHDA to be necessary for the financial feasibility of the project and consistent with the qualified allocation plan as implemented by the VHDA. The Transferable Virginia Housing Opportunity Tax Credit would be allowed to be awarded either to the qualified project itself, or at the election of the project, to an approved financial intermediary with the proceeds of the initial sale or transfer of the tax credit to benefit the qualified project. VHDA would be required to send written notice of the award to the owner of the project. The award notice would be required to state the amount of credit awarded for each year of the two-year credit period and stipulate that receipt of the credit is contingent upon issuance of an eligibility certificate.

The credit would be allowed against the individual income tax, estate and trust income tax, corporate income tax, bank franchise tax, insurance premiums license tax, and license tax telegraph, telephone, water, heat, light, power, and pipeline companies. This bill would provide that an insurance company claiming a the credit established under this bill against the taxes, licenses, and other fees, fines, and penalties imposed by the law regarding the Virginia Insurance Premium License Tax, including any retaliatory tax imposed on insurance companies would not be required to pay any additional tax as a result of claiming this credit. The housing opportunity tax credit would be permitted to fully offset any retaliatory tax imposed by Virginia.

This bill would provide that Transferable Virginia Housing Opportunity Tax Credit not used in a taxable year may be carried forward by a taxpayer for the succeeding five years.

This bill would provide that all or any portion of the Transferable Virginia Housing Opportunity Tax Credit issued for the benefit of a qualified project may be transferred, sold or assigned by or to any taxpayer. The transferee would be allowed to subsequently transfer any previously unclaimed tax credit to another taxpayer for subsequent tax years within the credit period and the carry-forward period. The transferor of the transferable tax credit and the transferee would be required to jointly file a copy of the written credit transfer agreement with the Department within 30 days of the transfer. Such filing of the written credit transfer agreement with the Department would perfect such transfer. The written agreement would be required to contain the following information:

- The name, address and taxpayer identification number of the parties to the transfer;
- The amount of transferable tax credit being transferred;
- The year the transferable tax credit was originally allowed to the transferor;
- The tax year for which the transferable tax credit may be claimed; and
- A representation by the transferor that the transferor has neither claimed for its own behalf nor conveyed such credits to any other transferee.

The Department would be required to develop a standard form for use by subsequent transferees of the transferable tax credit demonstrating eligibility for the transferee to reduce its applicable Virginia tax liabilities resulting from ownership of the transferable tax credit. The Department would be required to develop a system to record and track the transfers of the transferable tax credit and certify the ownership of the transferable tax credit and would be permitted promulgate rules to permit verification of the validity and timeliness of a transferable tax credit claimed upon a tax return pursuant to this article.

This bill would not require recapture of the Transferable Virginia Housing Opportunity Tax Credit in cases where a portion of any federal low-income housing credits taken on a qualified project is required to be recaptured or is otherwise disallowed.

This portion of the bill would be effective for fiscal years or other 12-month period designated by the VHDA beginning on and after January 1, 2022, but before July 1, 2025. However, this bill would provide that a taxpayer may claim the Transferable Virginia Housing Opportunity Tax Credit for taxable years beginning on and after January 1, 2023.

Similar Bills

House Bill 843 is substantially similar to this bill, except that it would not have the transferable credit proposed by this bill.

House Bill 824 would expand the Virginia Housing Opportunity Tax Credit so that it applies to certain qualified specialty population projects.

cc : Secretary of Finance

Date: 2/7/2022 JJS
SB47F161