DEPARTMENT OF TAXATION
2022 Fiscal Impact Statement

1. **Patron** Mamie E. Locke

2. **Bill Number** SB 47
House of Origin:
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
__X__ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. **Committee** House Finance

4. **Title** Enhancement of the Virginia Housing Opportunity Tax Credit

5. **Summary/Purpose:**

This bill would repeal the $15 million annual credit cap that is imposed on the Virginia Housing Opportunity Tax Credit. This would result in the credit no longer being subject to an annual credit cap. As a result, this would allow taxpayers to receive a state-level Virginia Housing Opportunity Tax Credit in an amount that is substantially similar to the amount of federal credit allocated or allowed by VHDA. This would thereby permit taxpayers to claim an allocation of credits for 10 years. Under current law, due to the $15 million annual credit cap, the Virginia Housing Development Authority ("VHDA") is required to allocate the credit for one year only.

In addition, this bill would repeal:

- Language allowing VHDA to impose certain fees designed to recoup its costs in administering the tax credit; and

- Language allowing the sale of tax credits to one or more unrelated taxpayers.

This bill would be effective for taxable years beginning on and after January 1, 2022.

6. **Budget amendment necessary:** Yes.
Item(s): Page 1, Revenue Estimates

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

8. **Fiscal implications:**

Administrative Costs

VHDA would incur annual administrative costs of approximately $200,000 in Fiscal Year 2022 and thereafter to administer this credit program. Such costs would be necessary to hire two full-time employees to implement this increased credit program. In addition, this bill would repeal VHDA's ability to collect fees for administering the credit program. VHDA is self-supporting and generally does not receive state appropriations.

The Department of Taxation ("the Department") considers implementation of this bill as routine and does not require additional funding. This assumes that VHDA would provide information regarding credit allocations in an electronic format.

Revenue Impact

This bill would result in a significant unknown negative General Fund revenue impact beginning as early as Fiscal Year 2024. Based upon 2021 federal credit allocations, the stacking set forth in this bill would increase the revenue impact of the credit exponentially by $62 million annually, with a potential impact of:

- Approximately $248 million if the January 1, 2026 sunset date of this bill is not subsequently extended, or

- Approximately $620 million annually in later years if the January 1, 2026 sunset date of this bill is subsequently extended.

If credit allocations continue to be similar to 2021 credit allocations, after taking into account the $15 million revenue reduction currently assumed for the existing credit program, the negative revenue impact of this bill with its January 1, 2026 sunset date would be approximately $47 million in Fiscal Year 2024; $109 million in Fiscal Year 2025; $171 million in Fiscal Year 2026; $233 million in Fiscal Year 2027; and $233 million in Fiscal Year 2028. Because the credit program would not be subject to an annual cap, the actual amounts could be greater or less, depending on fluctuations in the federal tax credit program.

The amount of credits under this bill would be based on the amount of federal LIHTCs provided each taxable year. Based on data from VHDA, $62 million in federal LIHTCs were allocated to Virginia-based projects in 2021 as follows:

- Federal nine percent credits have typically been allocated to Virginia in an aggregate amount of approximately $24 million per year.

- $38 million in federal four percent credits were allocated to Virginia in 2021. Unlike the nine percent credits, the aggregate amount of four percent credits varies from year-to-year and recently appears to be increasing due to certain factors. For example, VHDA allocated $13.6 million in 2020; $9.7 million in 2019; and $3.3 million in 2018.

According to VHDA, the allocation of federal four percent credit amounts in Virginia has increased dramatically in recent years. VHDA indicated that there are a number of factors likely causing this, including a recent federal rule change fixing the rate at a set four percent as opposed to a floating rate that had previously been approximately three percent. Such change increased the equity these credits create for developers. As such, the number of applications for four percent credits has substantially increased. Accordingly, if the four percent credit allocations remain at around 2021 levels during subsequent years, this bill would result in $62 million in state credits being allocated for new projects annually. It is uncertain whether the four percent allocation levels will increase or decrease in subsequent years and by how much.

Unlike the annual caps that Virginia has typically imposed on recently enacted income tax credits, the allocation amounts under the federal credit would not limit the annual revenue impact of this bill to a specific dollar amount per fiscal year. Instead, the federal credit upon which the state credit under this bill would be based is generally claimed over a ten-year period, beginning with the year that the property is placed in service or, at the taxpayer's election, the following year. Therefore, for each qualified project, the amounts allocated in one year could be claimed fully in that year and also be claimed again in each following year for up to ten consecutive taxable years. As a result, the revenue impact of allocations made in prior years can stack together with the revenue impact of allocations made during the current year.

It is unclear whether this bill is intended to allow taxpayers to claim credits for projects that received federal credits prior to 2022. However, this bill would be limited to projects that were placed in service on or after January 1, 2021. If VHDA interprets the legislation to allow the issuance of such credits, this could increase the impact in the initial years to an unknown extent.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: Yes.

VHDA has determined in its regulations promulgated for the existing Virginia Housing Opportunity Tax Credit program that credits may be pre-allocated with respect to future years to the extent of the $15 million credit cap. Taxpayers that receive a pre-allocation of credits cannot claim such credits until the calendar year designated by VHDA.

As currently drafted, the bill does not specify what happens with respect to taxpayers who might have pre-allocations of Virginia Housing Opportunity Tax Credits, prior to the amendments that would be set forth in this bill. If the intent is to ensure that no credits under existing law may be pre-allocated and claimed in addition to the tax credits authorized by this bill, the following amendment is suggested to limit the existing credit to credits allocated or awarded during and for Calendar Year 2021:

> Page 2, Line 64, end of line
> Insert: 3. That notwithstanding any provision of law or regulation to the contrary, only credits awarded in Calendar Year 2021, up to a maximum of $15 million total for all taxpayers in all taxable years, may be claimed pursuant to the provisions of § 58.1-439.30 as set forth in Chapter 495 of the 2021 Acts of Assembly, Special Session I, prior to amendment by this act. Nothing in this enactment shall apply to § 58.1-439.30, as amended by this act.

If the intent is to allow such credits under existing law to continue to be pre-allocated and claimed in addition to the tax credits authorized by this bill, this may increase the tentative revenue estimates stated on Line 8 by up to $15 million per fiscal year.

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.

Taskforce and Report to Study Establishment of Virginia Credit

During the 2020 General Assembly Session, House Bill 810 was enacted, which required the Department of Housing and Community Development ("DHCD") and the 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.

Virginia Housing Opportunity Tax Credit

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.

Sunset Dates for New Income Tax Credits and Sales Tax Exemptions

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.

Proposed Legislation

This bill would repeal the $15 million annual credit cap that is imposed on the Virginia Housing Opportunity Tax Credit. This would result in the credit no longer being subject to an annual credit cap. As a result, this would allow taxpayers to receive a state-level Virginia Housing Opportunity Tax Credit in an amount that is substantially similar to the amount of federal credit allocated or allowed by VHDA. This would thereby permit taxpayers to claim an allocation of credits for 10 years. Under current law due to the $15 million annual credit cap, the VHDA is required to allocate the credit for one year only.

In addition, this bill would repeal:

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cc : Secretary of Finance

Date: 2/18/2022 JJS
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