AMENDED IN SENATE JUNE 16, 2010

AMENDED IN SENATE APRIL 22, 2010

SENATE BILL No. 1316

Introduced by Senator Romero

February 19, 2010

An act to amend Section 24941 of, and to add Sections 17053.9, 18036.8, and 23622.9 to, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

SB 1316, as amended, Romero. Income taxes: property exchanges: investment credits.

The Personal Income Tax Law and the Corporation Tax Law provide that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment, if that property is exchanged solely for property of a like kind that is to be held either for productive use in a trade or business or for investment.

This bill would exclude from that nonrecognition any exchange of out-of-state real property that is purchased in exchange for real property located in California.

The Personal Income Tax Law and Corporation Tax Law authorize various credits against the taxes imposed by those laws.

This bill would authorize a credit under both those laws, for taxable years beginning on or after January 1, ~~2010~~ *2011,* in a specified amount for investments in low-income communities, as provided. This bill would impose specified duties on the ~~Franchise Tax Board~~ *Treasurer* with regard to the application for, and allocation of, the credit.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares all of the following:

(a) The granting of tax benefits for the purchase of real property located beyond California's borders is of no direct benefit to the people of the State of California, and does not advance any legitimate local purpose.

(b) The revenue from disallowing these tax benefits, which are currently obtained from the exchange of property for like kind property, commonly known as a 1031 exchange, can instead be used to foster greater economic development within California's borders, and this development advances a legitimate local purpose.

(c) While this disallowance will remove a tax benefit in the form of deferred capital gains taxes from investors who purchase out-of-state properties, these funds amount to only 10 percent of California's total 1031 exchanges. Furthermore, the lion's share of the tax benefits for these investment purchases exists at the federal, rather than the state level. For this reason, no substantial decrease in out-of-state real estate investments is anticipated as a result of this legislation.

(d) In the current economic climate, the acquisition of revenue to stimulate in-state economic development cannot be achieved by any non discriminatory alternative.

~~SECTION 1.~~

SEC. 2. Section 17053.9 is added to the Revenue and Taxation Code, to read:

~~17053.9. (a) (1) For taxable years beginning on or after~~

17053.9. There is hereby created the California New Markets Tax Credit Program as provided in this section and Section 23622.9. The purpose of this program is to stimulate economic development, and hasten California's economic recovery, by granting tax credits for investment in California, including, but not limited to, retail businesses, real property, financial institutions, and schools. The Treasurer shall have responsibility for the administration of this program as provided in this section and Section 23622.9. The program shall be as follows:

(a) (1) For taxable years beginning on or after January 1, ~~2010~~ *2011*, there shall be allowed to a taxpayer that holds a qualified equity investment on a credit allowance date of the investment which occurs during the taxable year, as a credit against the "net tax," as defined in Section 17039, an amount equal to the applicable percentage described in paragraph (2).

(2) For purposes of paragraph (1), the applicable percentage shall be:

(A) Five percent of the qualified equity investment for the first three credit allowance dates.

(B) Six percent of the qualified equity investment for the succeeding ~~six~~ *four* credit allowance dates.

(b) For purposes of this section:

(1) "Credit allowance date" means, with respect to any ~~quality~~ *qualified* equity investment, the date on which the investment is initially made and the six succeeding annual anniversary dates.

(2) "Equity investment" means either of the following:

(A) Any stock, other than nonqualified preferred stock as defined in Section 351(g)(2) of the Internal Revenue Code, in an entity which is a corporation.

(B) Any capital interest in an entity which is a partnership.

(3) (A) "Low-income community" means a population census tract where any of the following applies:

(i) The tract has a poverty rate of at least 20 percent.

(ii) The tract is not located within a metropolitan area and the median family income does not exceed 80 percent of the statewide median family income.

(iii) The tract is located within a metropolitan area and the median family income does not exceed 80 percent of the greater statewide median family income or the metropolitan area median family income.

(iv) The tract is located within a high migration rural county and the median income does not exceed 85 percent of the statewide median family income. For purposes of this clause, "high migration rural county" means a county which, during the 20-year period ending with the year in which the most recent census was conducted, has a net out migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of that period.

(B) Where a community is in a location that is not tracted for population census tracts, the equivalent county divisions shall be used for purposes of determining poverty rates and median family income.

(C) Where a community is in a population census tract with a population of less than 2,000, the community shall be treated as a low-income community if the tract is within an empowerment zone designated under Section 1391 of the Internal Revenue Code and is contiguous to one or more low-income communities, as determined under this paragraph.

(4) (A) “Qualified active low-income community business” means, with respect to any taxable year, a corporation, including a nonprofit corporation, or partnership that, for that taxable year, meets all of the following conditions:

(i) Derives at least 50 percent of its total gross income from the active conduct of a qualified business in a low-income community.

(ii) A substantial portion of the use of the tangible property of the entity, whether owned or leased, is within a low-income community. *“Substantial portion” shall be defined as 40 percent or more of the tangible property of the entity.*

(iii) Less than 5 percent of the average of the aggregate unadjusted base of the property of the entity is attributable to collectibles, as defined in Section 408(m)(2) of the Internal Revenue ~~Code, other than collectibles that are held primarily for sale to customers in the ordinary course of the entity’s business.~~ *Code.*

(iv) Less than 5 percent of the average of the aggregate unadjusted base of the property of the entity is attributable to nonqualified financial property, as defined in Section 1397C(e) of the Internal Revenue Code.

(B) A “qualified active low-income community business” shall include a business carried on by an individual as a proprietor if that business meets the requirements of subparagraph (A) were it incorporated or a trade or business which would qualify if that trade or business were separately incorporated.

(5) “Qualified business” has the same meaning as that in Section 1397C(d) of the Internal Revenue Code except that:

(A) In lieu of applying subparagraph (B) of paragraph (2), the rental to others of real property located in any low-income community shall be treated as a qualified business if there are substantial improvements located on that real property.

(B) Paragraph (3) of that section shall not apply.

(6) (A) "Qualified community development entity" means a domestic corporation or partnership that meets all of the following conditions:

(i) Has a primary mission of serving, or providing investment capital for, low-income communities or low-income persons.

(ii) Maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity.

(iii) Is certified by the Treasurer for purposes of this section as being a qualified community development entity.

(B) A domestic corporation or partnership shall be deemed a "qualified community development entity" if it is either a specialized small business investment company, as defined in Section 1044(c)(3) of the Internal Revenue Code, or a community development financial institution, as defined in Section 4702 of Title 12 of the United States Code.

(7) (A) "Qualified equity investment" means any equity investment in a qualified community development entity if all of the following conditions are met:

(i) The investment is acquired by the taxpayer at its original issue, directly or through an underwriter, solely in exchange for cash.

(ii) Substantially all of the cash is used by the qualified community development entity to make low-income community investments. This requirement shall be deemed met if at least 85 percent of the aggregate gross assets of the qualified community development entity are invested in qualified low-income community investments.

(iii) The investment is designated for purposes of this section by the qualified community development entity.

(B) "Qualified equity investment" does not include any equity investment issued by a qualified community development entity more than five years after the date that the entity receives an allocation under subdivision (d). Any allocation not used within that five-year period may be reallocated by the Treasurer under subdivision (d).

(C) A “qualified equity investment” shall include any equity investment which would, notwithstanding clause (i) of subparagraph (A), be a qualified equity investment in the hands of the taxpayer if the investment was a qualified equity investment in the hands of a prior holder.

(D) Section ~~1203(c)(3)~~ *1202(c)(3)* of the Internal Revenue Code, relating to purchases by a corporation of its own stock, shall apply.

(8) “Qualified low-income community ~~investments”~~ *investment”* means any of the following:

(A) Any capital or equity investment in, or loan to, a qualified low-income community business.

(B) Any capital or equity investment in, or loan to, a real estate project in a low-income community.

(C) The purchase from another qualified community development entity of any loan made by that entity which is a qualified low-income community investment.

(D) Financial counseling and other services in support of business activities to businesses located in, and residents of, low-income communities.

(E) Any equity investment in, or loan to, a qualified community development entity.

(c) The ~~Franchise Tax Board~~ *Treasurer* shall prescribe regulations, guidelines, or procedures necessary or appropriate to carry out the purposes of this section. The regulations shall include, but are not limited to, criteria by which additional populations may be treated as low-income communities, the criteria by which entities are qualified active low-income community businesses with respect to low-income communities, and rules to avoid abuse of the purposes of the section.

(d) (1) The aggregate amount of credit that may be allowed in any calendar year pursuant to this section and Section 23622.9 shall be an amount equal to the aggregate revenue increase attributable in that same calendar year to Sections 18036.8 and 24941, as amended by the act adding this section, as certified by the Franchise Tax Board so as to achieve a revenue neutral effect.

(2) The aggregate amount of credit specified under paragraph (1) shall be allocated by the ~~Franchise Tax Board among taxpayers~~ *Treasurer among entities* that apply for the allocation. The ~~Franchise Tax Board~~ *Treasurer* shall give priority to applications that either are submitted by an entity that has a record of

successfully providing capital or technical assistance to disadvantaged businesses or communities or entities that intend to make qualified low-income community investments in one or more businesses in which persons unrelated to the entity hold the majority equity interest.

(e) Any ~~amounts deducted~~ *credits used* under subdivision (a) for a qualified equity investment where a recapture event occurs at any time before the close of the seventh taxable year after the qualified equity investment shall be included in the income in the taxable year in which the recapture event occurred. For purposes of this subdivision, a "recapture event" shall include any of the following with respect to an equity investment in a qualified community development entity:

(1) The qualified community development entity ceases to be a qualified community development entity.

(2) The proceeds of the investment cease to be used as required under clause (ii) of subparagraph (A) of paragraph (7) of subdivision (b).

(3) The investment is redeemed by a qualified community development entity.

~~SEC. 2.~~

SEC. 3. Section 18036.8 is added to the Revenue and Taxation Code, to read:

18036.8. For taxable years beginning on or after January 1, ~~2010~~ *2011*, the provisions of Section 1031 of the Internal Revenue Code, relating to the exchange of property held for productive use or investment, shall not apply to out-of-state real property that is ~~purchased~~ *received* in exchange for real property located in California.

~~SEC. 3.~~

SEC. 4. Section 23622.9 is added to the Revenue and Taxation Code, to read:

~~23622.9. (a) (1) For taxable years beginning on or after~~

23622.9. There is hereby created the California New Markets Tax Credit Program as provided in this section and Section 17053.9. The purpose of this program is to stimulate economic development, and hasten California's economic recovery, by granting tax credits for investment in California, including, but not limited to, retail businesses, real property, financial institutions, and schools. The Treasurer shall have responsibility for the *administration of this program as provided in this section and Section 17053.9. The program shall be as follows:*

(a) (1) For taxable years beginning on or after January 1, ~~2010~~ *2011*, there shall be allowed to a taxpayer that holds a qualified equity investment on a credit allowance date of the investment which occurs during the taxable year, as a credit against the "tax," as defined in Section 23036, an amount equal to the applicable percentage described in paragraph (2).

(2) For purposes of paragraph (1), the applicable percentage shall be:

(A) Five percent of the qualified equity investment for the first three credit allowance dates.

(B) Six percent of the qualified equity investment for the succeeding ~~six~~ *four* credit allowance dates.

(b) For purposes of this section:

(1) "Credit allowance date" means, with respect to any ~~quality~~ *qualified* equity investment, the date on which the investment is initially made and the six succeeding annual anniversary dates.

(2) "Equity investment" means either of the following:

(A) Any stock, other than nonqualified preferred stock as defined in Section 351(g)(2) of the Internal Revenue Code, in an entity which is a corporation.

(B) Any capital interest in an entity which is a partnership.

(3) (A) "Low-income community" means a population census tract where any of the following applies:

(i) The tract has a poverty rate of at least 20 percent.

(ii) The tract is not located within a metropolitan area and the median family income does not exceed 80 percent of the statewide median family income.

(iii) The tract is located within a metropolitan area and the median family income does not exceed 80 percent of the greater statewide median family income or the metropolitan area median family income.

(iv) The tract is located within a high migration rural county and the median income does not exceed 85 percent of the statewide median family income. For purposes of this clause, "high migration rural county" means a county which, during the 20-year period ending with the year in which the most recent census was conducted, has a net out migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of that period.

(B) Where a community is in a location that is not tracted for population census tracts, the equivalent county divisions shall be used for purposes of determining poverty rates and median family income.

(C) Where a community is in a population census tract with a population of less than 2,000, the community shall be treated as a low-income community if the tract is within an empowerment zone designated under Section 1391 of the Internal Revenue Code and is contiguous to one or more low-income communities, as determined under this paragraph.

(4) (A) "Qualified active low-income community business" means, with respect to any taxable year, a corporation, including a nonprofit corporation, or partnership that, for that taxable year, meets all of the following conditions:

(i) Derives at least 50 percent of its total gross income from the active conduct of a qualified business in a low-income community.

(ii) A substantial portion of the use of the tangible property of the entity, whether owned or leased, is within a low-income community. *"Substantial portion" shall be defined as 40 percent or more of the tangible property of the entity.*

(iii) Less than 5 percent of the average of the aggregate unadjusted base of the property of the entity is attributable to collectibles, as defined in Section 408(m)(2) of the Internal Revenue ~~Code, other than collectibles that are held primarily for sale to customers in the ordinary course of the entity's business.~~ *Code.*

(iv) Less than 5 percent of the average of the aggregate unadjusted base of the property of the entity is attributable to nonqualified financial property, as defined in Section 1397C(e) of the Internal Revenue Code.

(B) A "qualified active low-income community business" shall include a business carried on by an individual as a proprietor if that business meets the requirements of subparagraph (A) were it incorporated or a trade or business which would qualify if that trade or business were separately incorporated.

(5) "Qualified business" has the same meaning as that in Section 1397C(d) of the Internal Revenue Code except that:

(A) In lieu of applying subparagraph (B) of paragraph (2), the rental to others of real property located in any low-income community shall be treated as a qualified business if there are substantial improvements located on that real property.

(B) Paragraph (3) of that section shall not apply.

(6) (A) "Qualified community development entity" means a domestic corporation or partnership that meets all of the following conditions:

(i) Has a primary mission of serving, or providing investment capital for, low-income communities or low-income persons.

(ii) Maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity.

(iii) Is certified by the Treasurer for purposes of this section as being a qualified community development entity.

(B) A domestic corporation or partnership shall be deemed a "qualified community development entity" if it is either a specialized small business investment company, as defined in Section 1044(c)(3) of the Internal Revenue Code, or a community development financial institution, as defined in Section 4702 of Title 12 of the United States Code.

(7) (A) "Qualified equity investment" means any equity investment in a qualified community development entity if all of the following conditions are met:

(i) The investment is acquired by the taxpayer at its original issue, directly or through an underwriter, solely in exchange for cash.

(ii) Substantially all of the cash is used by the qualified community development entity to make low-income community investments. This requirement shall be deemed met if at least 85 percent of the aggregate gross assets of the qualified community development entity are invested in qualified low-income community investments.

(iii) The investment is designated for purposes of this section by the qualified community development entity.

(B) "Qualified equity investment" does not include any equity investment issued by a qualified community development entity more than five years after the date that the entity receives an allocation under subdivision (d). Any allocation not used within that five-year period may be reallocated by *the* Treasurer under subdivision (d).

(C) A “qualified equity investment” shall include any equity investment which would, notwithstanding clause (i) of subparagraph (A) of this paragraph, be a qualified equity investment in the hands of the taxpayer if the investment was a qualified equity investment in the hands of a prior holder.

(D) Section ~~1203(c)(3)~~ *1202(c)(3)* of the Internal Revenue Code, relating to purchases by a corporation of its own stock, shall apply.

(8) “Qualified low-income community ~~investments”~~ *investment”* means any of the following:

(A) Any capital or equity investment in, or loan to, a qualified low-income community business.

(B) Any capital or equity investment in, or loan to, a real estate project in a low-income community.

(C) The purchase from another qualified community development entity of any loan made by that entity which is a qualified low-income community investment.

(D) Financial counseling and other services in support of business activities to businesses located in, and residents of, low-income communities.

(E) Any equity investment in, or loan to, a qualified community development entity.

(c) The ~~Franchise Tax Board~~ *Treasurer* shall prescribe regulations, guidelines, or procedures necessary or appropriate to carry out the purposes of this section. The regulations shall include, but are not limited to, criteria by which additional populations may be treated as low-income communities, the criteria by which entities are qualified active low-income community businesses with respect to low-income communities, and rules to avoid abuse of the purposes of the section.

(d) (1) The aggregate amount of credit that may be allowed in any calendar year pursuant to this section and Section 17053.9 shall be an amount equal to the aggregate revenue increase attributable in that same calendar year to Sections 18036.8 and 24941, as amended by the act adding this section, as certified by the Franchise Tax Board, so as to achieve a revenue neutral effect.

(2) The aggregate amount of credit specified under paragraph (1) shall be allocated by the ~~Franchise Tax Board among taxpayers~~ *Treasurer among entities* that apply for the allocation. The

~~Franchise Tax Board~~ *Treasurer* shall give priority to applications that either are submitted by an entity that has a record of successfully providing capital or technical assistance to disadvantaged businesses or communities or entities that intend to make qualified low-income community investments in one or more businesses in which persons unrelated to the entity hold the majority equity interest.

(e) Any ~~amounts deducted~~ *credits used* under subdivision (a) for a qualified equity investment where a recapture event occurs at any time before the close of the seventh taxable year after the qualified equity investment shall be included in the income in the taxable year in which the recapture event occurred. For purposes of this subdivision, a "recapture event" shall include any of the following with respect to an equity investment in a qualified community development entity:

(1) The qualified community development entity ceases to be a qualified community development entity.

(2) The proceeds of the investment cease to be used as required under clause (ii) of subparagraph (A) of paragraph (7) of subdivision (b).

(3) The investment is redeemed by a qualified community development entity.

~~SEC. 4.~~

SEC. 5. Section 24941 of the Revenue and Taxation Code is amended to read:

24941. (a) Section 1031 of the Internal Revenue Code, relating to exchange of property held for productive use or investment, shall apply, except as otherwise provided.

(b) For taxable years beginning on or after January 1, ~~2010~~ *2011*, the provisions of Section 1031 of the Internal Revenue Code, relating to the exchange of property held for productive use or investment, shall not apply to out-of-state real property that is ~~purchased~~ *received* in exchange for real property located in California.

~~SEC. 5.~~

SEC. 6. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

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