

AMENDED IN SENATE JUNE 28, 2010
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, 2011, *and before January 1, 2012*, in a specified amount for investments in low-income communities, as provided. This bill would impose specified duties on the 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:

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

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

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

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

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

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

25 17053.9. There is hereby created the California New Markets
26 Tax Credit Program as provided in this section and Section
27 23622.9. The purpose of this program is to stimulate economic
28 development, and hasten California’s economic recovery, by
29 granting tax credits for investment in California, including, but
30 not limited to, retail businesses, real property, financial institutions,
31 and schools. The Treasurer shall have responsibility for the
32 administration of this program as provided in this section and
33 Section 23622.9. The program shall be as follows:

1 (a) (1) For taxable years beginning on or after January 1, 2011,
2 *and before January 1, 2012*, there shall be allowed to a taxpayer
3 that holds a qualified equity investment on a credit allowance date
4 of the investment which occurs during the taxable year, as a credit
5 against the “net tax,” as defined in Section 17039, an amount equal
6 to the applicable percentage described in paragraph (2).

7 (2) For purposes of paragraph (1), the applicable percentage
8 shall ~~be~~ *be 39 percent of the qualified equity investment*.

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

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

13 (b) For purposes of this section:

14 (1) “Credit allowance date” means, with respect to any qualified
15 equity investment, the date on which the investment is initially
16 made ~~and the six succeeding annual anniversary dates~~.

17 (2) “Equity investment” means either of the following:

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

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

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

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

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

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

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

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

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

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

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

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

21 (iii) Less than 5 percent of the average of the aggregate
22 unadjusted base of the property of the entity is attributable to
23 collectibles, as defined in Section 408(m)(2) of the Internal
24 Revenue Code.

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

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

34 (5) “Qualified business” has the same meaning as that in Section
35 1397C(d) of the Internal Revenue Code except that:

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

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

1 (6) (A) “Qualified community development entity” means a
2 domestic corporation or partnership that meets all of the following
3 conditions:

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

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

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

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

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

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

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

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

31 (B) “Qualified equity investment” does not include any equity
32 investment issued by a qualified community development entity
33 more than ~~five years~~ *one year* after the date that the entity receives
34 an allocation under subdivision (d). ~~Any allocation not used within~~
35 ~~that five-year period may be reallocated by the Treasurer under~~
36 ~~subdivision (d).~~

37 (C) A “qualified equity investment” shall include any equity
38 investment which would, notwithstanding clause (i) of
39 subparagraph (A), be a qualified equity investment in the hands

1 of the taxpayer if the investment was a qualified equity investment
2 in the hands of a prior holder.

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

5 (8) “Qualified low-income community investment” means any
6 of the following:

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

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

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

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

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

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

27 (d) (1) The aggregate amount of credit that may be allowed in
28 any calendar year pursuant to this section and Section 23622.9
29 shall be an amount equal to the aggregate revenue increase
30 attributable in that same calendar year to Sections 18036.8 and
31 24941, as amended by the act adding this section, as ~~certified~~
32 *estimated* by the Franchise Tax Board, so as to achieve a revenue
33 neutral effect.

34 (2) The aggregate amount of credit specified under paragraph
35 (1) shall be allocated by the Treasurer among entities that apply
36 for the allocation. The Treasurer shall give priority to applications
37 that either are submitted by an entity that has a record of
38 successfully providing capital or technical assistance to
39 disadvantaged businesses or communities or entities that intend
40 to make qualified low-income community investments in one or

1 more businesses in which persons unrelated to the entity hold the
2 majority equity interest.

3 (e) Any credits used under subdivision (a) for a qualified equity
4 investment where a recapture event occurs at any time before the
5 close of the seventh taxable year after the qualified equity
6 investment shall be included in the income in the taxable year in
7 which the recapture event occurred. For purposes of this
8 subdivision, a “recapture event” shall include any of the following
9 with respect to an equity investment in a qualified community
10 development entity:

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

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

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

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

20 18036.8. For taxable years beginning on or after January 1,
21 2011, *and before January 1, 2012*, the provisions of Section 1031
22 of the Internal Revenue Code, relating to the exchange of property
23 held for productive use or investment, shall not apply to out-of-state
24 real property that is received in exchange for real property located
25 in California.

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

28 23622.9. There is hereby created the California New Markets
29 Tax Credit Program as provided in this section and Section
30 17053.9. The purpose of this program is to stimulate economic
31 development, and hasten California’s economic recovery, by
32 granting tax credits for investment in California, including, but
33 not limited to, retail businesses, real property, financial institutions,
34 and schools. The Treasurer shall have responsibility for the
35 administration of this program as provided in this section and
36 Section 17053.9. The program shall be as follows:

37 (a) (1) For taxable years beginning on or after January 1, 2011,
38 *and before January 1, 2012*, there shall be allowed to a taxpayer
39 that holds a qualified equity investment on a credit allowance date
40 of the investment which occurs during the taxable year, as a credit

1 against the “tax,” as defined in Section 23036, an amount equal
2 to the applicable percentage described in paragraph (2).

3 (2) For purposes of paragraph (1), the applicable percentage
4 shall be: *be 39 percent of the qualified equity investment.*

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

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

9 (b) For purposes of this section:

10 (1) “Credit allowance date” means, with respect to any qualified
11 equity investment, the date on which the investment is initially
12 made ~~and the six succeeding annual anniversary dates.~~

13 (2) “Equity investment” means either of the following:

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

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

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

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

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

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

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

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

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

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

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

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

17 (iii) Less than 5 percent of the average of the aggregate
18 unadjusted base of the property of the entity is attributable to
19 collectibles, as defined in Section 408(m)(2) of the Internal
20 Revenue Code.

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

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

30 (5) “Qualified business” has the same meaning as that in Section
31 1397C(d) of the Internal Revenue Code except that:

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

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

37 (6) (A) “Qualified community development entity” means a
38 domestic corporation or partnership that meets all of the following
39 conditions:

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

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

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

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

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

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

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

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

28 (B) “Qualified equity investment” does not include any equity
29 investment issued by a qualified community development entity
30 more than ~~five years~~ *one year* after the date that the entity receives
31 an allocation under subdivision (d). ~~Any allocation not used within~~
32 ~~that five-year period may be reallocated by the Treasurer under~~
33 ~~subdivision (d).~~

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

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

1 (8) “Qualified low-income community investment” means any
2 of the following:

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

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

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

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

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

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

23 (d) (1) The aggregate amount of credit that may be allowed in
24 any calendar year pursuant to this section and Section 17053.9
25 shall be an amount equal to the aggregate revenue increase
26 attributable in that same calendar year to Sections 18036.8 and
27 24941, as amended by the act adding this section, as ~~certified~~
28 *estimated* by the Franchise Tax Board, so as to achieve a revenue
29 neutral effect.

30 (2) The aggregate amount of credit specified under paragraph
31 (1) shall be allocated by the Treasurer among entities that apply
32 for the allocation. The Treasurer shall give priority to applications
33 that either are submitted by an entity that has a record of
34 successfully providing capital or technical assistance to
35 disadvantaged businesses or communities or entities that intend
36 to make qualified low-income community investments in one or
37 more businesses in which persons unrelated to the entity hold the
38 majority equity interest.

39 (e) Any credits used under subdivision (a) for a qualified equity
40 investment where a recapture event occurs at any time before the

1 close of the seventh taxable year after the qualified equity
2 investment shall be included in the income in the taxable year in
3 which the recapture event occurred. For purposes of this
4 subdivision, a “recapture event” shall include any of the following
5 with respect to an equity investment in a qualified community
6 development entity:

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

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

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

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

16 24941. (a) Section 1031 of the Internal Revenue Code, relating
17 to exchange of property held for productive use or investment,
18 shall apply, except as otherwise provided.

19 (b) For taxable years beginning on or after January 1, 2011, *and*
20 *before January 1, 2012*, the provisions of Section 1031 of the
21 Internal Revenue Code, relating to the exchange of property held
22 for productive use or investment, shall not apply to out-of-state
23 real property that is received in exchange for real property located
24 in California.

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