

CALIFORNIA BUDGET IMPASSE AFFECTS STATE TAX CREDITS

California recently completed its annual budget drama between Governor Schwarzenegger and the California Legislature. The resulting compromise, the Budget Act of 2008, contains many material changes with one stealth provision in particular that could prove troublesome for California's affordable housing developers.

AB 1452, passed as part of the Budget Act, temporarily limits the amount of business tax credits (including the California Low Income Housing Tax Credit) that can be used to reduce California income tax liability in tax years 2008 and 2009. Use of credits would be limited to 50 percent of the taxpayer's California income tax liability. Taxpayers with net business income of less than \$500,000 would be exempt from this limitation. The amount of any credit that is not allowed due to this 50% limitation remains a credit carryover amount. The carryover period for any credit that is not allowed due to the 50% limitation is increased by the number of taxable years the credit (or any portion thereof) was not allowed.

This change could have a material effect upon the pricing of California state tax credits. The change could materially curtail the utility of the credit due to the present value loss of the first two years of the four-year credit period. Affordable housing developers that have sought state tax credits may need to revisit the pricing of those credits with their tax credit investors. Many investors are as yet unaware of this change and thus their pricing models may not accurately account for the reduction in utility of the credits. In addition, AB 1452 could have the effect of causing a tax credit shortfall for transactions that closed earlier in 2008. Such a shortfall could trigger a tax credit guaranty payment obligation.

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