

AFFORDABLE HOUSING

CLIENT ALERT

FEBRUARY 22, 2010

CALIFORNIA PROPOSAL WOULD ELIMINATE THE EXCLUSION FOR LIKE-KIND EXCHANGES BUT CREATE A NEW EXCLUSION FOR AFFORDABLE HOUSING PROJECTS

On Friday, February 19, 2010, Assembly Member Juan Arambula introduced tax legislation that would make very significant changes to the taxation of real estate in California. Key changes proposed under Assembly Bill 2640 include:

- **Create** a new California **exclusion** for gain or loss from the sale of an **assisted housing development** to certain specified purchasers where the assisted housing development's **affordability is maintained** after the sale
- **Eliminate** the present California **exclusion** for gain or loss from **like-kind exchanges** under I.R.C. Section 1031 for taxable years beginning on or after January 1, 2010
- **Eliminate** the present California **exclusion** for gain or loss from **involuntary conversions** under I.R.C. Section 1033 for taxable years beginning on or after January 1, 2010

New Affordable Housing Exclusion. AB 2640 would modify California Revenue and Taxation Code Section 18041.5 as follows:

No gain shall be recognized with respect to a sale of an assisted housing development to a tenant association, nonprofit organization, profit-motivated organization or individual, or public agency which obligates itself ... to maintain the assisted housing development affordable to persons or families of lower income or very low income for either a period of 30 years from the date of sale or the remaining term of existing federal government assistance ..., whichever is greater, provided that all of the proceeds from the sale are reinvested in residential real property, other than a personal residence, in this state within two years after the sale.

This proposed exclusion for affordable housing therefore requires that the sale (1) be limited to certain specified purchasers (although it is an extremely broad list of purchasers); (2) results in the maintenance or extension of the affordability requirements; and (3) results in the reinvestment of all proceeds in residential real property. The provisions are quite complex, especially with regard to procedural rules and notices, and borrow to some extent from concepts that presently exist for the noticing of sales of affordable housing projects under California Government Code Section 65863.10. As a practical matter, since most affordable housing projects in California are already subject to 55-year affordability restrictions, the requirement of maintaining affordability after the sale is not a significant limitation.

The proposed exclusion would be very meaningful to most tax credit-financed affordable housing projects because such projects generally have substantial built-in phantom income by the end of the tax credit compliance period. Similar proposals have been advanced at the federal level in recent years but none have gathered significant support up to this point.

Like-Kind Exchanges. Over the years, California has strongly adhered to the notion of conformity with federal tax laws. AB 2640's proposal to eliminate the exclusion from state tax for like-kind exchanges is a surprising move away from such conformity. Given that AB 2640 would be effective as of January 1, 2010, prospective sellers must now consider the possibility that AB 2640 could be applicable to currently pending transactions.

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It is, of course, impossible to predict the likelihood that AB 2640 will eventually be enacted. While it might seem reasonable to discount the prospects of such an extreme change, California's structural budget crisis is a very real one. In the current atmosphere it could be extremely dangerous to assume that the tax environment in California will remain unchanged in the coming year.

Prospective sellers need to consider carefully the impact of AB 2640 with their own tax advisors. Certain of the provisions in AB 2640 are less than clear examples of draftsmanship. Given that AB 2640 was introduced only last Friday, it is uncertain how some of the provisions would operate, if enacted. This Affordable Housing Alert is intended to provide notice of the introduction of AB 2640 but cannot be relied upon as advice for any purpose. For those wishing more information, please contact:

Stephen C. Ryan at 415.262.5150 or sryan@coxcastle.com

Lisa D. Weil at 415.262.5175 or lweil@coxcastle.com

Ofer Elitzur at 415.262.5165 or uelitzur@coxcastle.com

Elizabeth S. Anderson at 415.262.5152 or banderson@coxcastle.com