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Bill Analysis

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Primary Sponsor: Rep. Pavliga

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SUMMARY

Low-income housing tax credit

- Authorizes a nonrefundable state tax credit that piggybacks on the federal low-income housing tax credit (LIHTC) for affordable housing projects.
- Allows the Executive Director of the Ohio Housing Finance Agency (OHFA) to reserve a state tax credit for any project in Ohio that receives a federal LIHTC allocation, as long as the project is located in Ohio and begins renting units between 2023 and 2029.
- Generally limits the amount of state credits that may be reserved in a fiscal year to $500 million, but allows unreserved credit allocations and recaptured credits to be added to the credit cap for the next fiscal year.
- Allows the Executive Director to determine the amount of state credit reserved for a qualified project so long as the reserved amount is no more than necessary to ensure the financial feasibility of the project.
- Specifies that, like the federal LIHTC, the state credit is claimed over a ten-year credit period starting no sooner than the year in which the qualified project is placed in service.
- Stipulates that the annual credit amount equals the lesser of one-tenth of the state credit amount reserved for the project or the amount of the federal LIHTC for the first year of the credit period, adjusted as described in the bill.
- Allows any direct or indirect equity owner in a project owner that is a pass-through entity to claim the Ohio credit regardless of whether the equity owner is eligible to claim the federal LIHTC.
- Allows the credit to be claimed by any number of project or equity owners, against different taxes, and over multiple calendar years, tax years, taxable years, or tax

periods, so long as the total credit claimed does not exceed the amount specified on the eligibility certificate.

- Allows project and equity owners to claim an advance credit after the project is placed in service but before the Director issues an eligibility certificate so long as they reconcile any difference between the advance credit amount and the actual credit amount through an amended tax return or report.
- Requires that, for any federal LIHTC that is clawed back or disallowed for a particular project, a proportional amount of Ohio credit be clawed back or otherwise disallowed.

Subsidized residential rental property valuation

- Requires the Tax Commissioner to adopt a uniform tax valuation formula for federally subsidized residential rental property that takes into account a property's operating income and expenses and a uniform capitalization rate.
- Sets a minimum total value for subsidized residential rental property of 150% of the value of the underlying land.
- Requires the owner of a subsidized residential rental property to annually report the property's operating income and expenses to the county auditor of the county in which the property is located.

DETAILED ANALYSIS

Overview

The bill authorizes a tax credit for low-income housing developments and addresses the way in which subsidized residential rental property is valued for tax purposes.

State low-income housing tax credit authorization

The bill authorizes a business tax credit that piggybacks an existing federal income tax credit for the construction or rehabilitation of affordable rental housing. Like the federal low-income housing tax credit (LIHTC), the credit authorized by the bill is claimed in equal amounts over a ten-year credit period that begins no sooner than the year in which the project is placed in service, i.e., the building is made available to tenants. Subject to certain limitations, the amount of the state credit is determined by the Executive Director of the Ohio Housing Finance Agency (OHFA), referred to in the bill as the "Director." The credit may be claimed by the project owner, or, if the project owner is a pass-through entity, any person who owns a direct or indirect interest in the project owner. Those eligible to claim a credit may apply it against any of several state taxes. The credit is nonrefundable, but may be claimed up to five years after the applicable year of the credit period. The total amount of state credits reserved by the Director is generally limited to $500 million per fiscal year, and the Director is prohibited from reserving credits after January 1, 2029.

Federal low-income housing tax credit

The federal LIHTC is a federal income tax credit that offsets a portion of a developer's construction costs in exchange for reserving a certain number of rent-restricted units for lower-income households in a new or rehabilitated facility. The federal government assigns a credit allotment to each state or territory based on population. State housing agencies then award the credits to private developers through a competitive application process. In Ohio, the federal LIHTC is administered by the OHFA. State housing agencies are required to develop a plan, known as a qualified allocation plan (QAP), to evaluate and award tax credits to projects that satisfy federal requirements.[1]

To receive a federal LIHTC, developers must apply to the OHFA before undertaking a project. If the project preliminarily qualifies for a credit, based on federal criteria and the state's QAP, the OHFA may set aside (or "allocate") one for that project. Receipt of the credit is contingent upon completion of the project and placing it in service, generally within two years of allocation. In practice, developers typically sell the rights to claim federal LIHTCs upon receiving an allocation to secure up-front financing necessary to undertake the project.

There are two types of federal LIHTCs: (1) a larger credit, sometimes called the "9% credit," that subsidizes approximately 70% of the developer's qualified basis in the project (determined based on the developer's nonland investments in the project and the percentage of the building reserved for affordable housing), and (2) a smaller credit, sometimes called the "4% credit," that subsidizes approximately 30% of the developer's qualified basis. The 9% credit is competitively awarded, and generally reserved for new construction, while the 4% credit is available to any project that utilizes a threshold percentage of federally tax-exempt bond financing, including rehabilitation projects. Both credits are claimed in equal amounts over a ten-year credit period, beginning when the project is placed in service.[2]

Ohio low-income housing tax credit

Any project that is allocated a federal LIHTC may also qualify for the Ohio LIHTC authorized by the bill, as long as the project is located in Ohio and placed into service at any time on or after January 1, 2023, and before or on January 1, 2029 (referred to in the bill as a "qualified project"). The Ohio LIHTC may be claimed against the income tax, financial institutions tax, or the tax on foreign and domestic insurance companies.[3]

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[1] For more information about Ohio's qualified allocation plan, see the OHFA 2022-2023 Qualified Allocation Plan (PDF), which may be accessed by conducting a keyword search for "Qualified Allocation Plan" on the OHFA's website: ohiohome.org.

[2] 26 United States Code 42; Congressional Research Service, An Introduction to the Low-Income Housing Tax Credit (PDF), which may be accessed by conducting a keyword search for "An Introduction to the Low-Income Housing Tax Credit" on the Congressional Research Service's website: crsreports.congress.gov.

[3] R.C. 175.16(A)(3) and (5) and (F)(1).

Reserved credit

Developers do not need to separately apply for the Ohio LIHTC. Instead, the Director may reserve a state credit for any qualified project when allocating a federal LIHTC to that project. When reserving a state credit, the Director must send written notice of reservation to each project owner, i.e., any person who holds a fee simple or leasehold interest in the land on which the project sits. The notice must include the aggregate amount of the state credit reserved for all years of the qualified project's ten-year credit period and state that the receipt of the state credit is contingent upon issuance of an eligibility certificate.

The amount of state credit reserved for any particular qualified project is determined by the Director, but in no case may the reserved credit, combined with the allocated federal credit, exceed the amount necessary to ensure the financial feasibility of the project. The bill does not define what is meant by financial feasibility.

The bill prohibits the Director from reserving a state LIHTC for any project after January 1, 2029.[4]

Awarded credit

After the qualified project is placed into service and the Director approves the final cost certification or otherwise determines the owner's qualified basis, the Director must issue an eligibility certificate to each project owner. The certificate must state the amount of the credit that may be claimed for each year of the ten-year credit period, the annual credit amount, which is the lesser of:

- The amount of the federal credit that would be awarded for the first year of the credit period absent a first-year reduction required by federal law;
- One tenth of the reserved credit amount stated in the notice reserving the state LIHTC.

This provision effectively caps the amount of a state LIHTC at the amount of the corresponding federal credit.

The eligibility certificate must also state the years that comprise the credit period, each project owner's name, address, and taxpayer identification number, the date it is issued, a unique identifying number, and any other information the Director requires by rule.

Each project owner that is a pass-through entity must provide a copy of the certificate to each of its equity owners that has been allocated a portion of the credit (see "**Allocating and reporting the credit**," below). Additionally, the Director must send copies of all eligibility certificates to the Tax Commissioner and Superintendent of Insurance.[5]

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[4] R.C. 175.16(A)(3), (B), and (F)(1) and (3).

[5] R.C. 175.16(A)(11), (D), and (E).

Credit limit

The aggregate amount of credits reserved for all qualified projects in any fiscal year generally may not exceed $500 million. For purposes of the calculation, the credit reserved for each qualified project is the aggregate amount of credits reserved for the project's full ten-year credit period.

However, if the amount of credits reserved in any year is less than the credit limit for that year, the difference may be carried forward and added to the credit limit for the following year. Additionally, any amount of credits recaptured as the result of an assessment made by the Tax Commissioner or Superintendent of Insurance may be added to the credit limit for the following year.[6]

Allocating and reporting the credit

If the project owner is a pass-through entity (PTE) – any entity disregarded as a taxpayer for federal income tax purposes – the bill allows the annual credit amount to be allocated among the project owner's "equity owners," i.e., any person that is a direct or indirect owner of the project owner. Equity owners may then assign all or part of their interest in the qualified project, including interests in credits, to one or more other equity owners. In other words, equity owners may assign their ownership interests in project owners, and with those interests the right to claim a tax credit may be transferred.

If a PTE project owner allocates a credit among its equity owners, it must list the amount of the credit allocated to each equity owner, and include that information with the project owner's tax return or report. The bill also requires each project owner that is awarded a state LIHTC to designate itself, or, if applicable, one of its equity owners as a "designated reporter." The designation must be made to the Tax Commissioner and Superintendent of Insurance in the time and manner each officer prescribes. Every calendar year, the designated reporter for each project awarded a credit must provide certain information to the Commissioner and Superintendent, again at the time and in the manner prescribed by the Commissioner, in consultation with the Superintendent. The report must contain all of the following:

- The name, address, and taxpayer identification number of each equity owner that has been allocated a portion of the annual credit amount;
- The amount of the annual credit allocated to each equity owner for that year and the tax against which the credit will be claimed;
- The total amount of all credits allocated among the equity owners listed in the report.

The bill also requires the designated reporter to inform the Commissioner and Superintendent if any of the reported information changes. This may be most likely to apply in the case of equity owners that assign their interest in a project and its credits, and each purchaser in those

[6] R.C. 175.16(C).

scenarios is required to inform the designated reporter so the reporter can identify the transferee.[7]

The bill specifies that the state LIHTC may be allocated among equity owners of a PTE project owner even if that allocation would be disallowed for the federal LIHTC, as long as the person that claims the state credit is considered an equity owner under state law and acquired the ownership interest before claiming the credit. Interests in equity owners, including interests in the state LIHTC, may be assigned to equity owners, who may claim the credits as long as the interest is acquired before the tax return claiming the credits is filed.[8]

Claiming the credit

The bill allows the project owners or equity owners to claim the state LIHTC against the state income tax, financial institutions tax, or insurance company premiums taxes. In order for an equity owner to claim a credit, the equity owner and the amount of the credit allocated to that equity owner must appear on the report filed with the Tax Commissioner and Superintendent of Insurance by the project's designated reporter (see "**Allocating and reporting the credit**," above).

The credit must be claimed for a calendar year or taxable year (depending on the tax it is claimed against) that includes all or part of the year of the credit period to which the credit it is attributed, or any of the five following years. The credit may be applied against more than one tax over more than one calendar year, tax year, taxable year, or tax period. The total credits claimed in connection with the applicable year of the project's credit period must not, however, exceed the amount stated on the eligibility certificate.[9]

Advance credit

For instances in which a project is placed in service before an eligibility certificate is issued, the bill provides a mechanism that allows the project owners or equity investors to claim an advance credit based on the notice of reservation. The advance credit available for the applicable credit period is one tenth of the reserved amount, stated in the notice of reservation (see "**Reserved credit**," above). If, after the eligibility certificate is issued, the actual annual credit amount is different than advance credit amount (see "**Awarded credit**," above), the project owners or equity investors that claimed the advance credit must reconcile the difference by filing an amended tax return or report.[10]

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[7] R.C. 175.16(F)(2), (4), and (6), and (I)(1) to (3).

[8] R.C. 175.16(F)(1), (2), and (5).

[9] R.C. 175.16(F)(1) and (I)(4), 5725.36, 5725.98, 5726.58, 5726.98, 5729.19, 5729.98, 5747.85, and 5747.98.

[10] R.C. 175.16(F)(3).

Clawback

Federal law allows for the recapture of federal LIHTCs. Under the bill, if any portion of the federal LIHTC allocated to a qualified project is recaptured, the Director must recapture a proportionate amount of the state credit allocated to the same project. The Director does so by certifying the name of each owner of the qualified project to the Tax Commissioner and Superintendent of Insurance, who must then determine the taxpayers that claimed the credit, the taxes against which it was claimed, and the amount to be recaptured. The Commissioner and Superintendent must then make an assessment to recover those credits. In this instance, the general three- or four-year limitations periods applicable to state tax assessments do not apply.[11]

Rules and information sharing

The bill requires the Director to adopt rules, in consultation with the Tax Commissioner and Superintendent of Insurance, necessary to administer the credit. Any rules adopted under the bill are exempted from continuing law's standard requirement that an agency must repeal two regulatory restrictions for each one it enacts. Generally, a regulatory restriction is a rule that includes the words "shall," must," require," "shall not," or "prohibit."

The bill also requires OHFA to share information with the Commissioner and Superintendent, or verify information, as is necessary to ensure compliance with the law. Likewise, the Department of Taxation is authorized to share information with OHFA, and verify information, for the same purpose.[12]

Valuation of subsidized residential rental property

The bill requires the Tax Commissioner to adopt rules prescribing a uniform tax valuation method for federally subsidized residential rental property, which is any property subsidized by the following programs, listed according to their most commonly used name and the section of federal law they are authorized under:

- Section 42, federal LIHTC;
- Section 202, Supportive Housing for the Elderly;
- Section 811, Supportive Housing for Persons with Disabilities;
- Section 8, Housing Choice Voucher Program;
- Section 515, Rural Rental Housing Loans;
- Section 538, Guaranteed Rural Rental Housing Program; and

[11] R.C. 175.16(G).

[12] R.C. 175.16(H) and (J) and 5703.21; R.C. 121.95, not in the bill.

- Section 521, USDA Rural Rental Assistance Program.[13]

Generally, under continuing law and practice, real property is appraised for tax purposes by a county auditor by using one of three methods – the income method (i.e., capitalizing the income generated by the property), cost method (i.e., the cost of constructing or improving the property), or comparable sales method (i.e., a comparison of the neighborhood sales prices of comparable properties).[14] All three methods are employed to value real property at its true, or fair market value, which is the uniform standard that all real property, except certain agricultural property, must be valued at, as required by the Ohio Constitution.[15] In the context of federally subsidized rental housing, courts have generally held that using the income approach is superior to the other two approaches when determining the property's fair market value. These cases generally result in subject property's fair market value being determined on the basis of its market rent, rather than any subsidized contract rent.[16] Courts and continuing law additionally require any valuation to take into account the effect of limitations on the property's value due to involuntary, governmental actions, such as the rent restrictions federal subsidies may impose.[17]

Under current, recently enacted law, county auditors are explicitly authorized to use any of the three methods in valuing LIHTC property. The bill repeals this authorization and instead requires the Tax Commissioner to adopt rules prescribing a formula for the uniform valuation of all federally subsidized residential rental property, including LIHTC property.[18] The formula must take into account the operating income and expenses of the property, as reported by the owner, and a uniform capitalization rate.

The formula must consider one or two years of operating income, which includes gross potential rent and any income derived from other sources. Certain expenses are presumed as a percentage of gross potential rent: an allowance for vacancy losses (4%), unpaid rent losses (3%), and repair or replacement reserve fund contributions (5%). These presumptions may be exceeded based on any evidence of the actual expenses reported by the property owner. Operating expenses do not include property taxes, depreciation, and amortization expenses. Finally, the capitalization rate must be uniform and market-appropriate and include a tax additur accounting for the property tax rate applicable to a particular property's location. Though the bill prescribes the factors that must be included in the formula, the bill delegates the task of prescribing the formula to the Tax Commissioner.

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[13] R.C. 5713.031(A).

[14] Ohio Administrative Code (O.A.C.) 5703-25-05 and 5703-25-07.

[15] R.C. 5713.03; Ohio Constitution, Article XII, Section 2.

[16] See, e.g., *Alliance Towers v. Stark Cty. Bd. of Revision*, 37 Ohio St.3d 16, 23 (1988).

[17] R.C. 5713.03; *Woda Ivy Glen L.P. v. Fayette Cty. Bd. of Revision*, 121 Ohio St.3d 175, 2009-Ohio-762, ¶¶ 17, 23-24.

[18] R.C. 5713.03.

The rules must also set a minimum total value for subsidized residential rental property of 150% of the value of the unimproved land upon which it is situated (see **COMMENT**, below).[19]

The formula is only utilized so long as the property remains subject to the conditions and restrictions imposed by the federal program that subsidizes it. If it is no longer subject to federal restrictions, then the property is valued as other real property, presumably employing the income, cost, or comparable sales method.[20]

Information sharing

The bill requires the owner of subsidized residential rental property to report the property's operating income and expenses to the county auditor of the county in which the property is located. The report should include all of the information necessary to value the property via the formula described above, such as gross potential rent, any other income, losses due to vacancy or unpaid rent, and any contributions to a repair or replacement reserve fund. This information must be filed by an owner before the subject property is placed in service, after commencing operations, and each year on or before January 31. Any submitted information is not a public record. As with the formula, this submission is no longer required after the property is no longer subject to any federally imposed conditions and restrictions.[21]

COMMENT

The bill's requirement that the rules adopted by the Tax Commissioner for the valuation of federally subsidized residential rental property set a minimum total value of 150% of the value of the unimproved land presents a potential constitutional conflict. The Ohio Constitution requires that real property be taxed "by uniform rule according to value," meaning true or fair market value, i.e., the price for which the property would sell in a transaction between a willing buyer and seller.[22] By statutorily setting a minimum value, a subsidized rental property may be taxed based on a value that exceeds what the fair market value is as determined by either the bill's formula or one of the three valuation methods discussed above. However, the Ohio Supreme Court has noted that whether subsidized rental property should have more than a nominal tax value is a policy issue that the General Assembly might be able to address without conflicting with this constitutional requirement.[23]

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[19] R.C. 5715.01.

[20] R.C. 5713.031(A).

[21] R.C. 5713.031.

[22] Ohio Const. art. XII, sec. 2; *State ex rel. Park Investment Co. v. Bd. of Tax Appeals*, 175 Ohio St. 410, 412-13 (1964) (". . . no matter what method of evaluation is used, the ultimate result of such an appraisal must be to determine the amount which such property should bring if sold on the open market.").

[23] *Notestine Manor, Inc. v. Logan County Bd. of Revision*, 152 Ohio St.3d 439, 2018-Ohio-2, ¶¶ 30-32.

HISTORY

Action	Date
Introduced	02-15-23

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