State of California
Franchise Tax Board
chair John Chiang | member Betty T. Yee | member Michael C. Genest
Legal Division MS A260
PO Box 1720
Rancho Cordova, CA 95741-1720

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Legal Ruling 2009-02

SUBJECT: RECAPTURE OF CREDITS UNDER THE FORMER FARMWORKER HOUSING CREDIT PROVISIONS

ISSUE

Where a partnership receives an allocation of a farmworker housing credit under former Revenue and Taxation Code[1] section 17053.14,[2] which is passed through to its partners as a distributive share item under Subchapter K of the Internal Revenue Code (IRC),[3] and one of those partners transfers its partnership interest prior to the end of the compliance period, who is liable for recapture of the credit upon the occurrence of a disqualifying event?

FACTS

Situation 1

A limited partnership receives an allocation of a farmworker housing credit under section 17053.14. The limited partnership consists of one individual general partner ("A") that owns 0.01 percent and two individual limited partners ("B" and "C") that each own 49.995 percent. The credit is allocated among the partners in accordance with their interests in the partnership. Each partner properly claims and is able to utilize their entire share of the credit in Year 1. In Year 15, B transfers his entire partnership interest to an unrelated party ("D"). In Year 20, a disqualifying event with respect to the farmworker housing credit occurs.

Situation 2

Same as Situation 1, except B is only able to claim half of his share of the credit in Year 1. In Year 2, B transfers his entire partnership interest to D.

LAW AND ANALYSIS

Section 17053.14 allows a credit against the "net tax" for a percentage of eligible costs paid or incurred to construct or rehabilitate qualified farmworker housing.[4] Once allocated, the

[1] All section references will be to the Revenue and Taxation Code, unless otherwise specified.
[2] Section 17053.14 was repealed in 2008. (Stats. 2008, ch. 521, § 5.) This provision is applicable for farmworker housing credit allocations made prior to January 1, 2009.
[3] California generally conforms to the provisions of Subchapter K of the Internal Revenue Code under section 17851.
[4] Former section 23038.2 applies where the farmworker housing credit is claimed by an entity taxed as a corporation. Under section 23038.2, the credit is applied against the "tax" as defined under section 23036.

entire amount of the credit may generally be claimed in the first taxable year the farmworker housing is placed in service, applied against the taxpayer's "net tax" for that year (as defined in section 17039). Under section 17053.14, subdivision (j), any excess may be carried over to reduce the "net tax" in succeeding years, until the credit has been exhausted.

Where a partnership receives an allocation of the farmworker housing credit as the owner of the project, the credit will flow through to the partners in accordance with their interest in the partnership. (§ 17039, subd. (e)(2); IRC § 704.)[5] The distributive share of the credit then belongs to the partner and can be claimed against the partner's "net tax" and/or carried over as applicable.[6] Although the partners are the ones who ultimately apply the credit against their "net tax," the term "taxpayer," as used in section 17053.14, includes partnerships. (§§ 17039 & 17004.)

Section 17053.14, subdivision (f), paragraph (1), provides that the farmworker housing for which the credit is allowed must meet specified requirements for a period of 30 consecutive years. Under section 17053.14, subdivision (k), if a "disqualifying event" occurs prior to the expiration of the 30 year compliance period, a recapture amount will be added to the "net tax" for the year in which the disqualifying event occurred.

A disqualifying event occurs if the California Tax Credit Allocation Committee determines that the credit certification was obtained by fraud or misrepresentation, or the taxpayer fails to comply with the requirements under section 17053.14 or the Farmworker Housing Assistance Program.[7] (§ 17053.14, subd. (k); Cal. Code Regs., tit. 4, § 11002, subd. (p).) If the credit certification was obtained by fraud or misrepresentation, section 17053.14, subdivision (k), provides that the recapture amount is equal to the amount of the credit previously allowed, plus interest. Otherwise, the recapture amount is equal to the entire amount of the credit previously allowed multiplied by a fraction, the numerator of which is the number of years remaining in the compliance period and the denominator of which is 30. (§ 17053.14, subd. (k)(3)(B).)

The recapture amount will be imposed on the taxpayer that applied for the credit. (Cal. Code Regs., tit. 4, § 11002, subd. (p)(3).) Where a partnership received an allocation of the credit as the owner of the project, the recapture liability flows through to the partners in the taxable year in which the disqualifying event occurs in accordance with their interest in the partnership. (§ 17039, subd. (e)(2); IRC § 704.) Thus, the current partners at the time a disqualifying event occurs are liable for an addition to tax for their distributive share of the recapture amount even if they did not receive a share of the credit originally allowed.

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[5] Under sections 17053.14 and 17851, allocations of credit under Subchapter K are subject to the "substantial economic effect" rules of IRC section 704(b).

[6] As previously noted, where the partner is an entity taxed as a corporation, the credit will be allowed under section 23608.2 and applied against the "tax" as defined in section 23036.

[7] For more information on the California Tax Credit Allocation Committee and the Farmworker Housing Assistance Program, see the California State Treasurer's website at http://www.treasurer.ca.gov/ctcac/index.asp.

HOLDINGS

Situation 1

In Year 20, the partnership is required to recapture the applicable portion of the farmworker housing credit. Since A, C, and D were partners at the time the disqualifying event occurred, they are each liable for their distributive share of the recapture amount for the taxable year in which the disqualifying event occurred. Even though B claimed a share of the credit, B's tax will not be increased by the credit recapture amount.

Situation 2

In Year 2, B would claim any allowable farmworker housing credit carryover against his individual net tax. D would not be entitled to any portion of B's farmworker housing credit carryover since the credit carryover amount is not transferable.[8] In Year 20, the partnership is required to recapture the applicable portion of the credit. Since A, C, and D were partners at the time the disqualifying event occurred, they are each liable for their distributive share of the recapture amount for the taxable year in which the disqualifying event occurred.

DRAFTING INFORMATION

The principal author of this ruling is Jenna Mayfield of the Franchise Tax Board, Legal Division. For further information regarding this ruling, contact Ms. Mayfield at the Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, California 95741-1720.

[8] But see section 23663 in the case of a corporate partner which is a member of a unitary group.