Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Arambula	Analyst:	Nicole Kwon	Bill Number:	AB 2570
Related Bills:	See Legislative History	Telephone:	845-7800	Amended Date:	February 23, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT:	Community Development Financial Institution Investments Credit/Extend Repeal Date To January 1, 2011

SUMMARY

This bill would extend the repeal date of the Community Development Financial Institution Investments Credit.

This analysis addresses only those provisions of the bill affecting the Franchise Tax Board (FTB).

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to continue to allow taxpayers a credit for depositing money into community development financial institutions.

EFFECTIVE/OPERATIVE DATE

This bill would be effective immediately and operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Existing federal law allows a credit equal to 5% of contributions, up to $2 million for each corporate taxpayer, to community development corporations (CDCs), but not for deposits into a community development financial institution (CDFI). The Secretary of Housing and Urban Development may select 20 CDCs as eligible to receive contributions for purposes of this credit. Each CDC must be tax-exempt under federal law and promote employment and business opportunities for low-income individuals.

Board Position:			Department Director	Date
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Existing state law has not conformed to the federal credit for contributions to a CDC; however, current state law allows a credit equal to 20% of each qualified deposit made by any taxpayer into a CDFI. A qualified deposit is defined as a deposit that does not earn interest, or an equity investment that is equal to or greater than $50,000 and is made for a minimum duration of 60 months. A CDFI is defined as a private financial institution located in California and certified by the California Organized Investment Network (COIN) that has community development as its primary mission and lends in urban, rural, or reservation-based communities in California. A CDFI may include a community development bank, a community development loan fund, a community development credit union, a microenterprise fund, a community development corporation-based lender, and a community development venture fund.

State law limits the aggregate amount of qualified deposits made by all taxpayers to $10 million for each calendar year.

The credit applies for taxable years beginning on or after January 1, 1997, and before January 1, 2007.

State law requires COIN, or its successor, to certify and issue certificates regarding each CDFI, each qualified deposit, and the total amount of credit allocated. COIN also is required to provide FTB with an annual list of taxpayers, their identification numbers, the amount of their deposits, and the total amount of all qualified deposits.

In addition, state law requires a CDFI to apply to COIN for certification of its status and, on behalf of the taxpayer, certification of the credit amount allocated to the taxpayer. The CDFI is also required to:

- transmit to the taxpayer and COIN certification that a qualified deposit was accepted, the amount of the deposit, and the amount of the credit allocated to the depositor;
- obtain taxpayer information and provide it to COIN; and
- provide annually to the FTB and COIN a list of those taxpayers who make any early withdrawals or reductions of the qualified deposits.

THIS BILL

This bill would extend the repeal date of the CDFI credit from December 1, 2007, to January 1, 2011.

This bill would provide any unused credit amount to be carried forward to the new repeal date of January 1, 2011.

IMPLEMENTATION CONSIDERATION

This bill would raise the following implementation consideration.

The language under Revenue and Taxation Code Section 17053.57 (b), “the difference may be carried over to the next year, and any succeeding year during which this section remains in effect,” could be misleading to taxpayers. This bill does not clearly state whether the taxpayer needs to use the credit before January 1, 2007, or be able to carry over the unused credit amount to the new repeal date of January 1, 2011. The author's office may want to state clearly the actual date by which a taxpayer must carryover an unused credit amount.

LEGISLATIVE HISTORY

AB 2831 (Ridley-Thomas, 2005/2006) would extend the repeal date of the CDFI credit from December 1, 2007, to January 1, 2017. AB 2831 is currently at the Assembly Desk.

SB 409 (Vincent, Stats. 2001, Ch. 535), among other provisions, this bill extended the sunset date of the CDFI credit from January 1, 2002, to January 1, 2007.

AB 1520 (Vincent, Stats. 1997, Ch. 947), created the CDFI credit.

PROGRAM BACKGROUND

The department annually releases a report on state tax expenditures. Appendix 1 contains information from the 2005 State Tax Expenditure Report regarding the usage of the CDFI credit.

OTHER STATES' INFORMATION

The laws of *Florida, Illinois, Massachusetts, Michigan, Minnesota, New York*, and *Texas* were reviewed because their tax laws are similar to California's income tax laws. Except for *New York*, none of these states have a credit similar to the financial institution investment credit.

New York: Allows a credit against the insurance franchise tax for investing in certified capital companies. A "certified capital company" is a partnership, corporation, trust, or limited liability company, organized on a for-profit basis, that is located, headquartered, and licensed or registered to do business in New York, and that has as its primary business activity the investment of cash in qualified businesses. Similar to California, *New York* provides this credit to encourage investment in the state. The maximum aggregate amount of certified capital for which the credit may be allowed is $80 million for 2001 and $150 million for 2002. The credit is for 100% of the investment but may only be taken in 10% increments each year for 10 years.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the Personal Income Tax (PIT) and Corporation Tax revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 2570 Effective On Or After January 1, 2006 Enactment Assumed After June 30, 2006			
	2005-06	2006-07	2007-08
Community Investment	-$500,000	-$500,000	-$500,000

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The revenue impact of this bill would be determined by the amount of qualified investments in Community Development Financial Institutions located within California.

Maximum qualified investments in any calendar year are still limited to the aggregate of $10 million. Since 1999, credit usage has varied dramatically, from $21,000 to $1.4 million. Over the last five years, usage has averaged around $500,000 in PIT and Corporation tax combined. It is assumed, therefore, that losses in the future years will be around $500,000 annually.

LEGISLATIVE STAFF CONTACT

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Appendix I
Community Development Financial Institution Credit

This is a 20 percent credit for the amount of each “qualified investment” in a “community-development financial institution” (CDFI). A qualified investment is a deposit or loan that does not earn interest, or an equity investment, that is equal to or greater than $50,000 and is made for a minimum duration of 60 months. A CDFI is a private financial institution located in California and certified by the California Organized Investment Network (COIN) that has community development as its primary mission and lends in urban, rural, or reservation-based communities in California. A CDFI may include a community-development bank, a community-development loan fund, a community-development credit union, a micro-enterprise fund, a community development corporation-based lender and a community-development venture fund. This credit is scheduled to sunset for taxable years beginning on or after January 1, 2007.

Amount:
In tax year 2002, the amount of credits applied was $1.0 million.

Number of Tax Returns Affected:
In tax year 2002, credits were applied on 10 Personal Income Tax and four Corporation Tax returns.

Discussion:
The purpose of this credit is to increase investment in certain economically disadvantaged communities.

Most investments that qualify for this credit also qualify for the federal New Markets Tax Credit. The federal credit is five percent of qualified contributions in each of the first three years and six percent in each of the fourth through seventh years.

This program will be considered successful if it generates new investment activity in targeted communities. For any investments that would have been made anyhow, this provision represents a windfall gain to the taxpayer. The portion of investments receiving this credit that would not have been made in its absence is not known.

Another state program whose goals are very similar to the goals of this credit is the deduction available for loans made to economically depressed areas, including enterprise zones and targeted tax areas.

A policy alternative would be direct government funding of community development financial institutions.