Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Medina & V. Manuel Pérez	Analyst:	Diane Deatherage	Bill Number:	AB 1399
Related Bills:	See Prior Analysis	Telephone:	845-4783	Amended Date:	August 4, 2014
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	California New Markets Tax Credit

SUMMARY

This bill would allow a credit, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), in modified conformity with the federal New Markets Tax Credit (NMTC).

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The August 4, 2014, amendments added provisions related to the California NMTC and also made nonsubstantive technical changes. As a result of these amendments, several, but not all, of the implementation concerns and technical considerations as provided in the department's analysis of the bill as amended June 9, 2014, June 18, 2014, and July 3, 2014, have been resolved. Also, a new implementation concern and two additional technical considerations were identified as a result of the amendments.

Except for the "This Bill," "Implementation Considerations," "Technical Considerations," and "Economic Impact" sections, the remainder of the department's analysis of the bill as amended June 9, 2014, June 18, 2014, and July 3, 2014, still applies. The "Fiscal Impact" and "Policy Concerns" sections have been restated below for convenience.

THIS BILL

For taxable years beginning on or after January 1, 2015, and before January 1, 2027, this bill would, under both the PITL and CTL, allow a cumulative credit, as described below, equal to 39 percent of a taxpayer's qualified equity investment. The credit would be repealed by its own terms as of December 1, 2028.

The credit would be in conformity with the federal New Markets Tax Credit provisions, with the following modifications:

- Authorize the California Competes Tax Credit Committee (Tax Credit Committee) as the administering agency for the NMTC program.
- Replace references to "Secretary" with "committee," with some exceptions.

Board Position:						Legislative Director	Date
______	S	______	NA	X	NP	Gail Hall	8/8/14
______	SA	______	O	______	NAR		
______	N	______	OUA	______			

- Allow a 39 percent credit to be claimed in the following manner:
    - Zero percent for the first two credit allowance dates;
    - Seven percent on the third credit allowance date; and
    - Eight percent on each of the remaining credit allowance dates (fourth through seventh).
- Allow the credit to a taxpayer that holds the qualified equity investment on the credit allowance date and the six subsequent anniversaries of the credit allowance date.
- Specify that the credit cannot be sold and is nonrefundable.
- Allow the credit to be allocated to partners of a partnership without regard to substantial economic effect, within the meaning of IRC section 704(b).
- Require that a qualified community development entity be an entity that has an allocation agreement dated on or after January 2, 2012, with the Community Development Financial Institutions Fund of the U.S. Treasury that includes California within the service area.
- Require the qualified low-income community to be in California.
- Allow employees of a service-based qualified business to perform services outside the low-income community.
- Limit eligibility as a "qualified active low-income community business" to businesses located within census tracts that meet one of the following:
    - Poverty rate is greater than 30 percent;
    - Median family income is equal or less than 60 percent of the California median family income, if located within a non-metropolitan area;
    - Median family income is equal to or less than 60 percent of the greater of the California median family income or metropolitan area median family income, if located within a metropolitan area; or
    - Unemployment rate is at least 1.5 times the national average.
- Provide a rule for determining a low-income community when the U.S. Census Bureau discontinues using the decennial census to report median family income on a census tract basis.
- Allow startup businesses to be considered a qualified active low-income community business for California purposes.
- Allow an exception to the requirement that 85 percent of gross assets must be invested in a qualified low-income community investment for the duration of the seven-year credit period: if the investment meets the 85 percent test, even if sold, for a six-year period, then it would be deemed to meet the test for the seventh year. The qualified community development entity would not be required to reinvest any capital returned after the sixth year.
- Provide that a qualified active low-income community business would include an operating business that, at the time the initial investment is made, has 250 or less employees and is located in a low-income community.

- Provide that the Tax Credit Committee shall recapture the credit claimed on a return when:
    - Any portion of the federal NMTC has been recaptured. In this case, the committee's recapture would be proportionate to the federal recapture with respect to the qualified equity investment.
    - The Development Entity redeems or makes principal repayment with respect to a qualified equity investment prior to the seventh anniversary of the issuance of the qualified equity investment. In this case, the committee's recapture would be proportionate to the amount of the redemption or repayment with respect to the qualified equity investment.
    - The Development Entity fails to (1) invest at least 85 percent of the purchase price of the qualified equity investment in qualified low-income community investments in California within 12 months and (2) maintain at least 85 percent of such level of investment in qualified low-income community investments in California until the last credit allowance date.
- Allow credits in excess of a taxpayer's current year tax liability to be carried forward for seven subsequent years.
- Allow an aggregate annual amount of credits for each calendar year of up to $40 million, in addition to any unused credits allocated from the prior year. The maximum credits allocated over the life of this credit would be capped at $200 million.

The Tax Credit Committee would be required to establish and impose reasonable fees upon entities that apply for the credit allocation and develop guidelines to adopt an allocation process that would do the following:

- Create an equitable distribution process for allocation of the credit;
- Set minimum organizational capacity standards;
- Require annual reporting to the Tax Credit Committee by each community development organization that receives an allocation; and
- Provide that any unused credits are returned to the Tax Credit Committee for subsequent reallocation.

This bill would provide that the guidelines would not be subject to the rulemaking requirements of the Administrative Procedure Act.

The Tax Credit Committee would be required to post the information from the annual reporting by the qualified development entities and the geographic distribution of credits on its Web site.

Funding for this bill would be provided through the reallocation of previously authorized expenditures from the California State Sales and Use Tax Exclusion Program.[1]

---

[1] Revenue and Taxation Code section 6010.8.

This bill would require the California Alternative Energy and Advanced Transportation Financing Authority to annually determine the difference between the $100 million statutory limitation on the sales and use tax exclusion and the amount assigned during the calendar year. The difference would be made available to the Tax Credit Committee for award to qualified development entities in the following calendar year under the NMTC Program.

A qualifying community development entity shall provide the Tax Credit Committee with the name, address, and tax identification number of each investor and entity for which a credit was allocated by the qualifying community development entity. The committee shall provide this information to the Franchise Tax Board (FTB) in a manner determined by the FTB.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

It is unclear that the Tax Credit Committee would have the information required to be posted on their website. The author may wish to amend this bill to clarify the mechanism for obtaining and posting the specified information.

The recapture modification language is unclear. It is recommended that this bill be amended to clarify the following:

- Any recaptured credits must be returned to the committee by March 1 of the year following the recapture and allocated in the following calendar years as described. It is unclear whether recaptured credits would affect the $40 million annual limit or the $200 million cumulative limit.
- Recapture would be triggered upon the Development Entity providing notice to the Tax Credit Committee of circumstances authorizing recapture. If it is the author's intent for recapture to be triggered upon committee notification to the Development Entity of noncompliance, the bill should be amended.

The intent of the modification of IRC section 45D(d)(1)(A) is unclear and appears to be unnecessary as the modification duplicates existing federal language and can be deleted.

TECHNICAL CONSIDERATIONS

The recapture language contains technical errors. For example, the committee would recapture the credit when the Development Entity redeems or makes principal repayment with respect to a qualified equity investment prior to the seventh anniversary of the issuance of the qualified equity investment. It is inaccurate to state that a Development Entity would make principal repayment with respect to a qualified equity investment. The author may wish to amend the bill for clarity.

Subclause (III) of clause (iii) of subparagraph (B) of paragraph (9) of subdivision (c) of sections 17053.9 and 23622.9 should be amended where the term "Department of Insurance" appears, as it should be "Franchise Tax Board."

On page 39, line 23 after "qualified community development entity" delete "shall."

FISCAL IMPACT

Implementing this provision would result in costs of approximately $131,000 for fiscal year 2015/16 for information technology system programming changes and additional personnel hours, and $13,000 in annual on-going costs.

ECONOMIC IMPACT

Estimated Revenue Impact of AB 1399 As Amended August 4, 2014 Assumed Enactment After June 30, 2014 ($ in Millions)				
2014-15	2015-16	2016-17	2017-18	2018-19
$0.0	$0.0	- $1.6	- $5.7	- $10

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

POLICY CONCERNS

This bill would allow a taxpayer to obtain combined federal and state credits equal to 74 percent of the investment even in cases where the federal credit alone would make the Development Entity's low-income community investment economically feasible. Consequently, the author may wish to provide that a specified degree of economic necessity is present before the Development Entity may market the state credit.

LEGISLATIVE STAFF CONTACT

Diane Deatherage
Legislative Analyst, FTB
(916) 845-4783
diane.deatherage@ftb.ca.gov

Mandy Hayes
Revenue Manager, FTB
(916) 845-5125
mandy.hayes@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov