

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 Dates: August 19, 2014 and August 22, 2014
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	California New Markets Tax Credit
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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.

This analysis only addresses the provisions of this bill that impact the department’s programs and operations.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The August 19, 2014, and August 22, 2014, amendments would:

- Clarify that the Governor's Office of Business and Economic Development (GO-Biz) and the California Competes Tax Credit Committee (Tax Credit Committee) would allocate the authority to designate qualified equity investments to the California qualified equity development entities (CA Development Entities).
- Allow the Director of GO-Biz to delegate the administration of all or portions of the California New Markets Tax Credit Program within GO-Biz.
- Specify the types of businesses that are excluded from qualifying as qualified active low-income community businesses.
- Remove a previously proposed provision that would have turned off the federal law¹ that disregards allocation of partnerships that lack substantial economic effect.
- Specify that recaptured, reissued, and undesignated authority to designate qualified equity investments would not count toward annual or cumulative allocation limitation of authority to designate qualified equity investments.
- Clarify that GO-Biz would adopt guidelines for its responsibilities.
- Include language that requires Legislative appropriation before GO-Biz and the committee could make awards of authority to designate qualified equity investments.
- Make nonsubstantive, technical changes.

¹ Internal Revenue Code section 704(b).

Board Position:	Legislative Director	Date
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The August 19, 2014, and August 22, 2014, amendments resolved all of the technical considerations and implementation considerations as discussed in the department's analysis of the bill as amended August 4, 2014. The department has identified an additional technical consideration.

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 August 4, 2014, still applies. The Federal/State Law Section has been clarified and updated. The "Fiscal Impact" and "Policy Concerns" sections have been included below for convenience.

FEDERAL/STATE LAW

The federal New Markets Tax Credit (Internal Revenue Code section 45D) is generally allowed for a taxpayer's qualified low-income community investments (stock or equity interest) in a qualified community development entity (Development Entity), which must be a corporation or a partnership. The Development Entity's primary mission must be serving, or providing investment capital for low-income communities or low-income persons, as certified by the Secretary of the Treasury. The taxpayer's federal New Markets Tax Credit totals 39 percent of the qualified equity investment made in the Development Entity but is spread over a seven-year period as follows:

- A 5 percent credit for the year the qualified equity investment is purchased and for the first two years thereafter (i.e., 15 percent for the first three years).
- A 6 percent credit for years four through seven (i.e., 24 percent for the subsequent four years).

The federal New Markets Tax Credit expired on December 31, 2013, but is generally expected to be extended.

Before a Development Entity can sell qualified equity investments eligible for the federal New Markets Tax Credit, it must apply for and be granted an allocation of the credit from the Community Development Financial Institution Fund, a branch of the U.S. Department of the Treasury, through a competitive application and rigorous review process. Geographic diversity is not a consideration in the evaluation process.

The credit is determined by applying the above applicable percentage (five or six percent) to the amount paid to the Development Entity for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.

The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity: (1) ceases to be a qualified Development Entity; (2) the proceeds of the investment cease to be used as required; or (3) the equity investment is redeemed.

A Development Entity is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the Development Entity; and (3) that is certified by the Secretary of the Treasury as being a qualified Development Entity.

A qualified low-income community investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a Development Entity for cash, and includes an investment of a subsequent purchaser if such investment was a qualified low-income community investment in the hands of the prior holder.

Substantially all of the investment proceeds must be used by the Development Entity to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses; (2) certain financial counseling and other services specified in regulation prescribed by the Secretary to businesses located in and residents of low-income communities; (3) the purchase from another Development Entity of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another Development Entity.

A "low-income community" is a population census tract with either a poverty rate of at least 20 percent or median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income. For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary of the Treasury is required to prescribe regulations designating "targeted populations" as low-income communities for purposes of the federal New Markets Tax Credit. For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994 (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means: (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income, or 80 percent of the statewide non-metropolitan area median family income. A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under Internal Revenue Code (IRC) section 1391, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a corporation or partnership that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of a qualified business within any low-income community; (2) a substantial portion of the use of the tangible property of the business is within a low-income community; (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted basis of the property of the business is attributable to certain financial property or to certain collectibles. Sole proprietorships and portions of a business can also be treated as a qualified active low-income community business if certain requirements are met.

California does not conform to the federal New Markets Tax Credit.

As mentioned above, the Community Development Financial Institution Fund grants the allocation of the federal New Markets Tax Credits. This fund is also used as part of the federal Community Development Financial Institution Program, where the fund provides monetary awards directly to the Community Development Financial Institutions.

Existing California law provides a 20 percent state credit for each “qualified investment” in a California “community development financial institution”. Unlike the federal Community Development Financial Institution Program, the “qualified investment” in the California Community Development Financial Institution must be at least \$50,000, for a minimum duration of 60 months, and consist of either of the following:

- A deposit or loan that does not earn interest.
- An equity investment.

California law provides for a recapture of the Community Development Financial Institution credit if the “qualified investment” is reduced or withdrawn before the end of the 60-month period. This credit is operative through taxable years beginning before January 1, 2017.

For taxable years beginning on or after July 1, 2008, California allows corporations that are members of the same unitary combined reporting group to assign “eligible” credits to other members of the group. An “eligible” credit is any credit earned by the taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, that was eligible to be carried forward to the first taxable year beginning on or after July 1, 2008. The credit assignment is made by an irrevocable election. The assignor and assignee taxpayers must be members of the same combined reporting for the taxable year in which the credit is earned and the taxable year the credit is assigned.

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 accordance with the federal New Markets Tax Credit provisions, with the following modifications:

- Authorize GO-Biz and the Tax Credit Committee to administer the California New Markets Tax Credit Program.
- Replace references to "Secretary" with "GO-Biz," for allocation of the limitation.
- 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.
- Require that a CA Development Entity, as modified, 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.
- Allow startup businesses to be considered a qualified active low-income community business for California purposes.
- 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 certain types of businesses would be excluded from qualifying as a qualified active low-income community business (i.e., country club, gaming establishment, massage parlor, liquor store, golf course, charter school, or a sexually oriented business).
- Provide that GO-Biz would recapture the credit claimed on a return when:
 - Any portion of the federal New Markets Tax Credit has been recaptured. In this case, GO-Biz's recapture would be proportionate to the federal recapture with respect to the qualified equity investment.
 - The CA Development Entity redeems a qualified equity investment prior to the seventh anniversary of the issuance of the qualified equity investment. In this case, GO-Biz's recapture would be proportionate to the amount of the redemption with respect to the qualified equity investment.
 - The CA 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 allocation of authority to designate qualified equity investments for each calendar year based upon credits of up to \$40 million, in addition to any undesignated or reissued allocations of authority to designate qualified equity investment from the prior year. The maximum amount of allocation of authority to designate qualified equity investments allocated over the life of this program would be result in an amount based on an aggregate credit cap of \$200 million.

GO-Biz would be required to establish and impose reasonable fees upon entities that apply for the authority to designate qualified equity investments and develop guidelines to adopt an allocation process that would do the following:

- Create an equitable distribution process for allocation of the authority to designate qualified equity investments;
- Set minimum organizational capacity standards;
- Require annual reporting to GO-Biz by each CA Development Entity that receives an allocation; and
- Provide that any allocation of undesignated qualified equity investments is returned to GO-Biz for subsequent reallocation.

GO-Biz would develop guidelines for its responsibilities with respect to the allocation of the qualified equity investments and recapture of credit.

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

A CA Development Entity would provide GO-Biz with the name, address, and tax identification number of each investor and entity for which an authority to designate qualified equity investments was allocated by the CA Development Entity. The committee would provide this information to the Franchise Tax Board (FTB) in a manner determined by the FTB.

GO-Biz would be required to post the information, on its Web site, from the annual reporting by the CA Development Entities and the geographic distribution of the qualified active low-income community businesses assisted.

This bill would create the California New Markets Tax Credit Fund for the fees imposed on CA Development Entities that apply for the allocation of the authority to designate qualified equity investments. GO-Biz and the committee would only make awards in a calendar year in which the Legislature appropriates funds from the California New Markets Tax Credit Fund.

The cap for the credit provided by this bill would be based on previously authorized expenditures from the California State Sales and Use Tax Exclusion Program.²

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 of authority to designate qualified investments to CA Development Entities in the following calendar year under the California New Markets Tax Credit Program.

This bill would add severability language that would, upon a provision or application of a provision being invalidated by a court, allow the remaining provisions to remain in effect.

TECHNICAL CONSIDERATIONS

Page 49, line 20 should be amended where the term "taxpayer" appears, as it should be "qualified community development entity."

FISCAL IMPACT

Implementing this provision would result in costs of approximately \$131,000 for fiscal year 2015/16 for information technology system programming changes, changes to forms and instructions, and data capture, and \$13,000 in annual on-going costs.

² Revenue and Taxation Code section 6010.8.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1399 As Amended August 19, 2014, and August 22, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions)				
2014-15	2015-16	2016-17	2017-18	2018-19
\$0.0	\$0.0	-\$1.5	-\$5.4	-\$10

This analysis assumes that proper appropriations are made to the California New Markets Tax Credit Fund. This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill. In addition, this estimate only reflects the revenue impact to income and franchise taxes.

SUPPORT/OPPOSITION³

Support: Advantage Capital Partners, Association of California Life and Health Insurance Companies, California Urban Partnership, Clearinghouse CDFI, Enhanced Capital, League of California Cities, Southern California Investment Center (EB-5 Regional Center), TELACU, U.S. Congressman Jim Costa, U.S. Congressman Juan Vargas.

Opposition: Department of Finance.

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 CA 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 CA Development Entity may market the state credit.

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³ From Senate Rules Committee analysis, dated 08/19/14.