ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

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Related Bills:	See Legislative History	Telephone:	845-5718	Introduced Date:	December 3, 2012
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Community Development Financial Institution Investments Credit/Increase Aggregate Amount Of Qualified Investments To $20 Million Per Year

SUMMARY

This bill would increase from $10 million to $20 million per year, the aggregate amount of qualified investments eligible for the Community Development Financial Institution (CDFI) tax credit.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to encourage investors to provide additional financial products and services to people and communities that are underserved by traditional financial markets.

EFFECTIVE/OPERATIVE DATE

This bill would be effective immediately upon enactment and operative as of that date.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law allows a New Markets Tax Credit (NMTC) for taxpayers who make a qualified equity investment in a qualified community development entity (CDE).

The NMTC is taken over a seven-year period for a total of 39 percent of the value of the qualified investment—5 percent for the first three years and 6 percent for years four through seven that the qualified investment is held by the CDE. The federal limit on the total qualified investments from all taxpayers to CDEs for 2011 is $3.5 billion.

Existing state law has not conformed to the federal credit for contributions to CDEs; however, current state law allows a credit equal to 20 percent of the amount of each qualified investment made by any taxpayer during the taxable year into a CDFI. A qualified investment 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.

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A CDFI is defined as a private financial institution located within 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 annual certification of total qualified investments made by all taxpayers to all CDFIs at $10 million for each calendar year. However, if the aggregate amount of qualified investments made in any calendar year is less than $10 million, the difference may be carried over to the next year, and any succeeding calendar year up through and including 2017.

Each year, until July 1, 25 percent of the annual aggregate amount of qualified investment, or an amount or date determined by the Insurance Commissioner, is reserved for investments by admitted insurers.

Each year, until July 1, $3 million of the annual aggregate amount of qualified investment, or an amount or date determined by the Insurance Commissioner, is reserved for investments of $300,000 or less from individual investors.

The credit applies for taxable years beginning on or after January 1, 1997, and before January 1, 2017. A carry forward of up to four years is permitted if the tax credit cannot be used in a taxable year.

State law requires the COIN, or its successor, to certify and issue certificates regarding each CDFI, each qualified investment, and the total amount of credit allocated. The COIN also is required to provide the Franchise Tax Board (FTB) with an annual list of taxpayers, their identification numbers, the amount of their investments, and the total amount of all qualified investments.

In addition, state law requires a CDFI to apply to the 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 do the following:

- Transmit to the taxpayer and the COIN that a qualified investment was accepted;
- Transmit the amount of the investment and the amount of the credit allocated to the investor;
- Obtain taxpayer information and provide it to the COIN; and
- Provide annually to the FTB and the COIN a list of those taxpayers who make any early withdrawals or reductions of the qualified investments.

THIS BILL

This bill would increase the combined aggregate amount of qualified investments eligible for the CDFI tax credit under the Insurance Taxation Law, Personal Income Tax Law and Corporation Tax Law from $10 million per year to $20 million per year.

Because the CDFI tax credit is equal to a specified percentage of the invested amount, this bill would, by doubling the annual aggregate amount of qualified investments eligible for the credit, double the maximum CDFI tax credit available over the life of the credit.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 624 (Pérez, Chapter 436, Statutes of 2011) extended the repeal date of the CDFI credit from January 1, 2012, to January 1, 2017.

AB 2831 (Ridley-Thomas, Chapter 580, Statutes of 2006) extended the repeal date of the CDFI credit from January 1, 2007, to January 1, 2012.

SB 409 (Vincent, Chapter 535, Statutes of 2001) extended the repeal date of the CDFI credit from January 1, 2002, to January 1, 2007.

AB 1520 (Vincent, Chapter 947, Statutes of 1997) established the CDFI credit with a sunset date of January 1, 2002.

PROGRAM BACKGROUND

CDFIs have emerged over the last 20 years to provide opportunities for neglected and underdeveloped communities, businesses, and individuals that lack access to traditional sources of financing. CDFIs lend to borrowers that do not satisfy the criteria for conventional lenders. CDFIs may be banks, credit unions, or non-regulated non-profit institutions organized to gather private capital for community development lending or investing. Some CDFIs focus on a particular community while others lend to certain groups of people (minorities, women, low-income families, social service providers). All CDFIs are financial intermediaries that have a common mission of community development.

The impact of the state's personal income tax and corporation tax is capped at $2 million of new tax credit capacity per year. The department annually releases a report on state tax expenditures. In tax year 2009, the actual amount of CDFI credits claimed and allowed after return data validation was $250,000.

OTHER STATES' INFORMATION

The states reviewed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida allows a NMTC against the corporate income tax and insurance taxes. The program encourages capital investment in low-income communities by allowing taxpayers to earn credits by investing in qualified CDEs. In April 2012, the aggregate amount of credits available under the program increased to $163.8 million, subject to an annual cap of $33.6 million.

A person or entity that makes a qualified investment earns a vested tax credit equal to 39 percent of the purchase price of the qualified investment. For the first and second years the credit amount is zero. For the third year the credit is equal to 7 percent of the purchase price and for the fourth through seventh, the credit is equal to 8 percent. Any credit not fully used due to insufficient tax liability can be carried forward 5 years.

Illinois allows an income tax credit for investing capital in CDEs. Similar to California, *Illinois* provides this credit to encourage investment in low-income areas within the state. The credit is equal to 39 percent of the initial qualified investment and the credit is taken over a seven-year period, for which the initial investment remains with the CDE—zero percent for years one and two, seven percent for year three, and eight percent for years four through seven, with an annual cap of $20 million.

New York allows a credit against the insurance franchise tax for investing in certified capital companies. Similar to California, *New York* provides this credit to encourage investment in the state. The maximum aggregate amount of credit available for calendar years 2007 and forward is $60 million. The credit is equal to 100 percent of the initial qualified investment, but may only be taken in 10 percent increments beginning with the third year for which the initial investment remains with the certified capital company.

Review of *Massachusetts, Michigan, and Minnesota* laws found no comparable tax credits.

FISCAL IMPACT

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

ECONOMIC IMPACT

REVENUE ESTIMATE

This estimate does not include the revenue impact of the tax credits allowed against insurance tax.

Estimated Revenue Impact of AB 32 (As Introduced) For Taxable Years Beginning On or After January 1, 2013 Enactment Assumed By June 30, 2013			
2012-13	2013-14	2014-15	2015-16
-$50,000	-$150,000	-$200,000	-$350,000

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

SUPPORT/OPPOSITION

Support: The California Department of Insurance.

Opposition: None provided.

ARGUMENTS

Proponents**:** It could be argued that during these difficult economic times, with many public assistance programs being cut, it is important to encourage private development in underserved communities.

Opponents: Some taxpayers may say that with the state's current fiscal crisis, additional tax expenditures should be avoided.

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