

ANALYSIS OF AMENDED BILL

Author: Ridley-Thomas Analyst: Davi Milam Bill Number: AB 566
March 23, 2017 &
Related Bills: See Legislative History Telephone: 845-2551 Amended Dates: Corrected March 30, 2017
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Community Development Financial Institutions Credit

SUMMARY

This bill would, under the Insurance Code and the Revenue and Taxation Code, modify provisions of the Community Development Financial Institution Deposits Credit.

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

RECOMMENDATION – NO POSITION

SUMMARY OF AMENDMENTS

The March 23, 2017, amendments removed the provisions relating to the Sales and Use Tax Law, and replaced them with the provisions discussed in this analysis. The March 30, 2017, correction removed the urgency clause.

This is the department's first analysis of this bill.

REASON FOR THE BILL

The reason for this bill is to incentivize investors to provide financial products and services that benefit low-income communities underserved by traditional financial markets.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2018, and would extend the operative period of the credit to taxable years beginning on or after January 1, 2017, and before January 1, 2019. This bill would change the repeal date from December 1, 2017, to December 1, 2019. However, the law proposed for amendment is repealed by its own terms prior to the effective date of this bill.

In addition, the modified recapture rules would be operative for qualified investments reduced on or after January 1, 2018.

FEDERAL/STATE LAW

Existing federal law allows a New Markets Tax Credit (federal credit) for taxpayers who make an equity investment in specialized financial institutions referred to as a community development entity (Development Entity).

The federal credit totals 39 percent of the original investment amount and is claimed over a period of seven years (5 percent for each of the first three years and 6 percent for each of the remaining four years). The investment in the Development Entity may not be redeemed before the end of the seven-year period. The federal limit on the total qualified investments from all taxpayers to Development Entities for 2015 through 2019 is \$3.5 billion.

State Law

For taxable years beginning on or after January 1, 1997, and before January 1, 2017, the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allows a credit equal to 20 percent of the amount of each qualified investment in a Community Development Financial Institution (Financial Institution) made by a taxpayer during the taxable year. A qualified investment is defined as a deposit or loan that does not earn interest, or an equity investment, as specified. The investment must be equal to or greater than \$50,000 and invested for a minimum duration of 60 months.

State law limits the annual certification of total qualified investments made to Financial Institutions to \$50 million for each calendar year. If the aggregate amount of qualified investments authorized in any calendar year is less than \$50 million, the excess of \$50 million over the actual aggregate qualified investment made in any year may be carried forward to the next year, and any succeeding calendar year up through and including 2016.

State law requires the California Organized Investment Network (Investment Network), or its successor, to certify and issue certificates for each Financial Institution, qualified investments, and for the total amount of credit allocated. The Investment Network provides the Franchise Tax Board (FTB) with an annual list of taxpayers, their identification numbers, the amount of their investments, and a cumulative amount of total qualified investments. In addition, the Investment Network provides an annual listing to the FTB of the names and taxpayer identification numbers of any taxpayer who makes any withdrawal or partial withdrawal of a qualified investment before the expiration of 60 months from the date of the qualified investment.

Recapture Rules

The credit is subject to recapture if a qualified investment is withdrawn before the end of the 60th month period and not reinvested in another Financial Institution within 60 days. If a qualified investment is reduced before the end of the 60th month, but not below \$50,000, an amount equal to 20 percent of the total investment reduction is recaptured and added to tax for the taxable year in which the reduction occurs.

THIS BILL

This bill would, under the PITL and the CTL, extend the operative period of the Community Development Financial Institution Deposits Credit from taxable years beginning before January 1, 2017, to taxable years beginning before January 1, 2019. This bill would change the repeal date from December 1, 2017, to December 1, 2019. However, the law proposed for amendment will be repealed by its own terms on December 1, 2017, prior to the effective date of this bill.

This bill also would eliminate the existing exception to the recapture rules that apply when a qualified investment is reduced below \$50,000, and instead would apply the recapture rules to all qualified investments that are reduced before the end of the 60th month and not reinvested in another Community Development Financial Institution.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

The Community Development Financial Institution Deposits Credit, under current state law, will be repealed by its own terms on December 1, 2017, prior to the January 1, 2018, effective date of this bill. Thus, the current language “amending” the statute to extend the repeal date should be changed to “add” the repealed provision. If the author’s intent is to reauthorize the credit, the bill should be amended.

To address an inconsistency, on page 18, line 13, and on page 24, line 7, “or reduction” should be inserted after “withdrawal.”

LEGISLATIVE HISTORY

AB 778 (Caballero, 2017/2018) would extend the operative period of the Community Development Financial Institution Deposits Credit to taxable years beginning on or after January 1, 2017, and before January 1, 2022, and would specify a repeal date of December 1, 2022. However, similar to this bill, AB 778 seeks to amend a law that will be repealed by its own terms prior to AB 778’s effective date. AB 778 is pending before the Assembly Insurance and Assembly Revenue and Taxation Committees.

AB 1715 (Committee on Jobs, Economic Development, and the Economy, 2017/2018) would extend the operative period of the Community Development Financial Institutions Deposits Credit to taxable years beginning on or after January 1, 2017, and before January 1, 2019, and would specify a repeal date of December 1, 2019. AB 1715 would also create a California New Markets Tax Credit, in modified conformity to federal law. AB 1715 is pending before the Assembly.

SB 325 (Mendoza, 2017/2018) would change the repeal date for the Community Development Financial Institution Deposits Credit from December 1, 2017, to January 1, 2021, but leave unchanged the credit’s operative period. SB 325 is pending before the Senate Insurance and the Senate Governance & Finance Committee.

AB 2647 (Garcia & Medina, 2015/2016) would have extended the operative period and made other modifications to the Community Development Financial Institution Deposits Credit. AB 2647 failed to pass out of the Assembly by the constitutional deadline.

AB 2728 (Atkins, 2015/2016) would have extended the operative period and made other modifications to the Community Development Financial Institution Deposits Credit. AB 2728 failed to pass out of the Senate by the constitutional deadline.

AB 32 (Perez, Chapter 608, Statutes of 2013) increased from \$10 million to \$50 million per year, the aggregate amount of qualified investments eligible for the Community Development Financial Institution Deposits Credit.

AB 624 (Perez, Chapter 436, Statutes of 2011) extended the repeal date of the Community Development Financial Institution Deposits Credit from January 1, 2012, to January 1, 2017.

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 new markets tax credit against the corporate income tax and insurance taxes. 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 may be carried forward five years. The program encourages capital investment in low-income communities by allowing taxpayers to earn credits by investing in qualified Development Entities. The aggregate amount of credits available under the program is \$163.8 million, subject to an annual cap of \$33.6 million.

Illinois allows an income tax credit for investing capital in Development Entities. 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 Development Entity - zero percent for years one and two, 7 percent for year three, and 8 percent for years four through seven, with an annual cap of \$20 million.

Massachusetts allows a credit for investing in certified community development companies. *Massachusetts* provides the credit to encourage investment and improve economic opportunities for low- to moderate-income areas within the state. The maximum aggregate amount of credit available for calendar years 2015 through 2019 is \$6 million. The credit is equal to 50 percent of the initial qualified investment, subject to a maximum credit of \$1 million for any taxpayer. Any excess credit is refundable, or at the taxpayer's election may be carried forward for a period of one to five years.

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

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, taken in 10 percent increments beginning with the third year for which the initial investment remains with the certified capital company.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Estimate

A revenue estimate cannot be completed until the technical consideration discussed above has been addressed.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may say that this bill would continue to encourage private development in underserved communities.

Opponents: Some could argue that extending the state credit when federal funding is already in place to help underserved communities may unnecessarily divert limited state resources from other social programs that may lack federal funding.

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