

## BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
<b>Franchise Tax Board</b>	<b>Caballero, et al.</b>	<b>AB 778</b>

**SUBJECT:** Community Development Financial Institution Deposits Credit

### SUMMARY

This bill would, under the Insurance Code and the Revenue and Taxation Code, reenact the Community Development Financial Institution Deposits Credit, with modifications.

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

### REASON FOR THE BILL

The reason for this bill is to incentivize investors to provide financial products and services to people and communities underserved by traditional financial markets.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment, and specifically operative for taxable years beginning on or after January 1, 2017, and before January 1, 2022.

### FEDERAL 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, state law, under 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 60<sup>th</sup> month and not reinvested in another Financial Institution within 60 days. If a qualified investment is reduced before the end of the 60<sup>th</sup> 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, reenact the Community Development Financial Institution Deposits Credit for taxable years beginning on or after January 1, 2017, and before January 1, 2022. The credit would be repealed by its own terms on December 1, 2022.

This bill would apply recapture rules to all qualified investments that are withdrawn or reduced before the end of the 60<sup>th</sup> month and not reinvested in another Community Development Financial Institution.

### **LEGISLATIVE HISTORY**

AB 566 (Ridley-Thomas, 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, 2019, and would specify a repeal date of December 1, 2019. AB 566 is pending before the Assembly Appropriations Committee.

AB 2728 (Atkins, 2015/2016) would have extended 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, 2018, and changed the repeal date from December 1, 2017, to December 1, 2018. AB 2728 was vetoed by the Governor because the bill would have resulted in a revenue loss and was not considered with other spending proposals during budget deliberations.

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**

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

**ECONOMIC IMPACT**

**Revenue Estimate**

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 778 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$1.8	- \$3.2	- \$3.9

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

**Revenue Discussion**

Based on investment data reported by the California Organized Investment Network, the average annual certified community development investment eligible for the Community Development Financial Institution Deposits Credit is estimated to be \$50 million per year, resulting in a credit generated of \$10 million per year. Due to the timing of the enactment, it is assumed that 80 percent, or \$40 million in qualified investments would be made in 2017. This estimate assumes the remaining \$10 million would be carried over to the following year resulting in \$60 million in qualified investments in 2018, and \$50 million per year in 2019 through 2021.

Based on the same investment data, it is estimated that 45 percent, or \$3.6 million, of the credit generated would be used to offset income and franchise tax and the remaining credit would be used by insurance taxpayers (not included in this estimate). Based on FTB credit usage data, it is estimated that 25 percent, or \$1 million, of the credit would be used in the year generated and the remaining 75 percent would be used in the subsequent four years.

After applying a reduction of 5 percent beginning in 2018 for investments that are reduced or withdrawn before the 60<sup>th</sup> month period and not reinvested within 60 days, the estimated revenue loss would be approximately \$1 million in 2017 and \$2.5 million in 2018.

In addition, the split between corporate taxpayers and personal income taxpayers used is 90 percent and 10 percent, respectively.

The tax year estimates are converted to fiscal years, and then rounded to arrive at the estimates reflected in the above table.

**APPOINTMENTS**

None.

**SUPPORT/OPPOSITION<sup>1</sup>**

Support: Bankers Small Business CDC of California; Beneficial State Bank; California Apartment Association; California Bankers Association; California Capitol Financial Development Corporation; California Reinvestment Coalition; Capitol for Healthy Families and Community; Capital Impact Partners; Clearinghouse CDFI; Enterprise Community Loan Fund, Inc; Genesis LA; HCAP Partners; Mercy Loan Fund; Neighborhood Housing Services; Neighbor Works Homeownership Center ; Northern California Community Loan Fund; Northern Community Federal Credit Union; Pacific Community Ventures; Pharos Capital Group; Rural Community Assistance Corporation; Small Business Development Corporation of Orange County; Sunwest Bank; Vermont Slauson Economics Development Corporation.

Opposition: None noted.

**VOTES**

	<b>Date</b>	<b>Yes</b>	<b>No</b>
Concurrence	09/11/17	77	0
Senate Floor	09/06/17	40	0
Assembly Floor	05/31/17	76	0

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<sup>1</sup> As noted in the Senate Governance & Finance Committee analysis dated June 30, 2017.