



## **Bill Analysis**

Author: Committee on Jobs,  
Economic Development, and  
the Economy

Sponsor:

Related Bills: See Legislative  
History

Bill Number: AB 1572

Amended: January 3, 2022

## **SUBJECT**

California New Markets Tax Credit Program

## **SUMMARY**

This bill, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), would allow a credit in modified conformity with the federal New Markets Tax Credit. This bill would allow a total credit of up to 39 percent of amounts invested in certain California businesses over a seven-year period.

The California New Markets Tax Credit Program would be administered by the Governor's Office of Business and Economic Development (GO-Biz).

GO-Biz, in consultation with the Franchise Tax Board (FTB), would be required to develop a process to recapture the credit, and any recaptured investments would revert back to GO-Biz to be reissued and such amounts would be excluded from the annual or cumulative allocation limitation.

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

## **RECOMMENDATION**

No position.

## **SUMMARY OF AMENDMENTS**

The January 3, 2022, amendments changed the operative dates and sunset date, modified the recapture provision, listed the information qualified community development entities shall provide GO-Biz, specified GO-Biz shall share this information with the FTB, added a requirement that GO-Biz collect information necessary for Section 41 reporting, requires the Department of Finance (DOF) to notify GO-Biz of the appropriation of funds, prohibited taxpayers from also claiming deductions for the same investment, provided for sharing of information between GO-Biz and FTB, added an annual reporting requirement for FTB and made other nonsubstantive changes.

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## **REASON FOR THE BILL**

The reason for this bill is to encourage private sector investment in lower income communities by providing a tax incentive for investing in qualified community development entities.

## **ANALYSIS**

### *California New Markets Tax Credit*

For taxable years beginning on or after January 1, 2024, and before January 1, 2029, this bill would, under the PITL and CTL, allow a California New Markets Tax Credit, in modified conformity to the federal credit, as described below.

This bill would allow a credit to a taxpayer that holds qualified equity investments in a qualified community development entity. The credit amount is equal to a percentage of the amount paid to a qualified community development entity for the qualified equity investment. The percentage allowed would be as follows:

- Nine percent for the first credit allowance date;
- Five percent on each of the remaining credit allowance dates (second through seventh).

This bill would limit the application of the credit to qualified community development entities that invest in qualified active low-income community businesses. To be eligible as a "qualified active low-income community business" the business must:

- Be located within certain census tracts that are located in California and meet one of the following:
  - Poverty rate is greater than 30 percent;
  - Median family income is equal to 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.
- Be an operating business that, at the time the initial investment is made, has 250 or fewer employees and is located in one or more California low-income communities. This requirement would not apply to a business that is located in a tribal land trust held communally by a federally recognized tribe and managed by the tribal government.

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- Not derive 15 percent or more of its annual revenue from the rental or sale of real estate, except if the business is controlled by, or under common control with, a second business that (1) does not derive 15 percent or more of its annual revenue from the rental or sale of real estate and (2) is the primary tenant of the real estate leased from the first business.
- Not be a country club, gaming establishment, massage business or establishment, liquor store, charter school, or any business that operates or derives revenues from the operation of a sexually oriented business.

This bill also would do the following:

- Allow credits in excess of a taxpayer's current year tax liability to be carried forward for seven years.
- Prohibit taxpayers claiming the California New Markets Tax Credit from claiming otherwise allowable credits or deductions for the same investment.
- Allow the California New Markets Tax Credit in addition to the federal New Markets Tax Credit.

#### *Credit Allocation Process*

This bill would authorize GO-Biz to administer the California New Markets Tax Credit Program. As such, any references to "Secretary" in the Internal Revenue Code (IRC) would be replaced with "GO-Biz" as the administering agency for allocation of the investment designation limitation.

The authority to designate a qualified equity investment would only be allocated by GO-Biz for taxable years in which moneys are appropriated to GO-Biz for administration. The Department of Finance would be required to annually notify GO-Biz about whether the state budget provides sufficient authority for another California New Markets Tax Credit application round.

For those years in which moneys are appropriated, GO-Biz shall post a notice of the appropriation on its Internet web site homepage and send such notice to the Secretary of State and Legislative Counsel.

As part of the allocation process, GO-Biz is required to:

- Allow an aggregate annual amount of allocation to qualified equity investments for each calendar year based upon credits of up to \$100 million, in addition to any undesignated or reissued allocations of authority to qualified equity investment from the prior year. GO-Biz, in developing guidelines, would have the authority to adopt an allocation process that would consider specified items.

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- In consultation with the FTB, establish a process for recapture of the credit. In the event of a recapture, the tax imposed for the taxable year in which the recapture event occurs would be increased by the state credit recapture amount. The state credit recapture amount would be determined consistent with the federal requirements of Section 45D(g) of the IIRC. No deduction would be allowed for interest paid as a result of a recaptured credit.
- Reissue recaptured investments that revert back to GO-Biz. These amounts would be excluded from the annual or cumulative allocation limitation. The enforcement of the recapture provision would be subject to a six-month cure period.
- Adopt guidelines necessary or appropriate to carry out its responsibilities with respect to the allocation, monitoring, and management of the tax credit program authorized by this bill.
- Establish and impose reasonable fees upon entities that apply to defray the cost of administering the program. The fees collected would be deposited in the California New Markets Tax Credit Account established by this bill.

Pending notification from the DOF regarding appropriation of funds, for the credit allocation application process, GO-Biz would be required to accept applications on or before October 15, 2023, and award authority to designated qualified equity investments annually through 2028.

An approved applicant may transfer all or a portion of its certified qualified equity investment authority to its controlling entity or any subsidiary qualified community development entity of the controlling entity, provided that the applicant and the transferee notify GO-Biz within 30 calendar days of such transfer. The transferee shall be subject to the same rules, requirements, and limitations applicable to the transferor.

The qualified community development entity or any transferee is required to do the following:

- Within 200 calendar days of GO-Biz sending notice of certification, issue the qualified equity investment and receive cash in the amount certified.
- Within 205 calendar days of the applicant receiving notice of certification, provide GO-Biz evidence of the receipt of the cash investment.

If the qualified community development entity or transferee, does not receive the cash investment and issue the qualified equity investment within 200 calendar days of GO-Biz sending the certification notice, the certification would lapse and revert back to GO-Biz.

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The qualified community development entity must also:

- Provide GO-Biz with the names, addresses, and California corporation numbers, federal employer identification numbers, social security numbers or individual taxpayer identification numbers of the taxpayers that are eligible to utilize tax credits and any transfer of a qualified equity investment.
- Submit a report to GO-Biz that provides documentation as to the investment of at least 85 percent of the funds being deployed within one year of issuance in a qualified low-income community investments in qualified active low-income community businesses located in California.
- Annually report to GO-Biz during the following seven years specified information, and any other information requested by GO-Biz.

GO-Biz would be required to provide the FTB with the information provided by the qualified community development entity.

Unused credits could be carried over for seven years or until exhausted.

GO-Biz would be required to post the information, on its internet website, from the annual reporting by the qualified community development entities and the geographic distribution of the qualified active low-income community businesses assisted.

This bill would require the FTB to prescribe any rules or regulations that may be necessary or appropriate to implement the program that would be authorized by this bill. The FTB would have access to any documentation held by GO-Biz relative to the taxpayers who are authorized to apply the credits, as well as the application and reporting of the qualified community development entity.

#### *Data Sharing / Reporting*

The FTB would be allowed to disclose information to GO-Biz as necessary to implement the California New Markets Tax Credit.

The FTB would be required to annually provide to the Joint Legislative Budget Committee, by no later than March 1, a report of the total dollar amount of the credits claimed under this section with respect to the relevant fiscal year. A copy of this report shall be posted on the website of the FTB.

The credit would be repealed by its own terms as of December 1, 2029.

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.

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This bill, in order to comply with Revenue & Taxation Code (RTC) section 41, would provide specific goals, purposes, and objectives of the California New Markets Tax Credit Program. The goal of this credit would be to attract private sector investment in lower income communities in California. For the purposes of fulfilling the requirements of Section 41, the following information would be required to be collected:

- The amount of tax credits issued in the year.
- The number of operating businesses located in a low-income community that are assisted.
- The number of jobs created and retained as a result of qualified low-income community investments.

#### *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, 2024, and before January 1, 2029, subject to a specific appropriation for GO-Biz to administer the California New Markets Tax Credit Program.

#### *Federal/State Law*

##### *Federal Law*

The federal New Markets Tax Credit is generally allowed for a taxpayer's qualified low-income community investments (stock or equity interest) in a qualified community development entity, which must be a corporation or a partnership. The qualified community 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 qualified community 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 was extended by the Protecting American from Tax Hikes Act of 2015 (by Public Law (P.L.) 114-113) at \$3.5 billion annually through 2019. Pursuant to the Taxpayer Certainty and Disaster Tax Relief Act of 2019, the allocation amount for calendar years 2020 through 2025 was increased to \$5 billion. Any unallocated amount may be carried forward, but not beyond calendar year 2030.

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Before a qualified community 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 (Community 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 qualified community 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 six anniversary dates 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: (1) the entity ceases to be a qualified community development entity; (2) the proceeds of the investment cease to be used as required; or (3) the equity investment is redeemed.

A qualified community 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 qualified community development entity; and (3) that is certified by the Secretary of the Treasury as being a qualified community development entity.

A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a qualified community 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 qualified community 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 regulations prescribed by the Secretary to businesses located in and residents of low-income communities; (3) the purchase from another qualified community 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 qualified community development entity.

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A "low-income community" is a population census tract with either a poverty rate of at least 20 percent or median family income that 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.

### *State Law*

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

### *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 what "recapture process" would need to be established by GO-Biz and the FTB. The absence of clarity could lead to disputes between the agencies and taxpayers. The author may want to amend the bill to provide recapture rules. We suggest replacing the language in Sections 17053.9 and 23622.9, subdivision (c)(4)(A) with language similar to the existing recapture provisions for the California Competes Tax credit in RTC section 17059.2.

This bill uses terms and phrases that are undefined, i.e., "controlled by, or under common control with," "employee," "country club," "gaming establishment," "massage business or establishment," "liquor store," and "six-month cure period." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

This bill would require the FTB to promulgate regulations, however, regulations may not be necessary for FTB to implement the credit or recapture. It is recommended that the bill be amended to replace "shall" with "may" in Sections 17053.9 and 23622.9, subdivision. (l), to allow the FTB to issue regulations, if needed.

This bill would require the FTB to annually provide to the Joint Legislative Budget Committee, by no later than March 1, a report of the total dollar amount of the credits claimed with respect to the relevant fiscal year. It is recommended that the bill be amended to replace "March 1" with "April 1" and to add an end date to the



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reporting requirement. Additionally, it is recommended the phrase "fiscal year" be replaced with "taxable year"

### *Technical Considerations*

This bill would create an administrative restriction on the FTB as it would require the FTB to go through the Administrative Procedure Act process to issue non-regulatory guidance in publications and forms. It is recommend that the phrase "any rules or" be removed where it appears in this bill.

Subdivision (c)(2) of Sections 17053.9 and 23622.9 modifies Section 45D(d)(2) of the Internal Revenue Code to replace the phrase "any low-income community" with "any low-income community in California" every place it appears. This phrase also appears in Section 45D(d)(3) of the Internal Revenue Code. For clarity, it is recommended that the reference to "Section 45D(d)(2)" be replace with "Section 45D(d)."

### *Policy Considerations*

This bill provides for poverty rate limits for a low-income community business. Because the bill would conform to IRC section 45D, it would apply the federal definition of low-income community. If the author's intent is to modify the definition of low-income community, the author may wish to amend the bill.

While this bill would generally restrict the credit to businesses located within California low-income communities, this restriction would not apply to a business that is located in a tribal land trust held communally by a federally recognized tribe and managed by the tribal government.

## **LEGISLATIVE HISTORY**

AB 1259 (Luz Rivas, et al., 2019/2020), substantially similar to this bill, would have created a California New Markets Tax Credit Program. AB 1259 did not pass by the constitutional deadline.

AB 3101 (Blanca Rubio & Cervantes, 2019/2020), substantially similar to this bill, would have created a California New Markets Tax Credit Program. AB 1259 did not pass by the constitutional deadline.

AB 185 (Eduardo Garcia and Medina, 2015/2016), substantially similar to this bill, would have created a California New Markets Tax Credit Program. AB 185 did not by the constitutional deadline.

AB 2647 (Eduardo Garcia & Medina, et al., 2015/2016), substantially similar to this bill, would have created a California New Markets Tax Credit Program. AB 2647 did not pass by the constitutional deadline.

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AB 305 (V. Manuel Pérez, et al., 2013/2014) would have reduced the total amount of the New Jobs Tax Credit and created a California New Markets Tax Credit Program for taxable years beginning on or after January 1, 2013, and before January 1, 2020. AB 305 did not pass by the constitutional deadline.

AB 1399 (Medina, and V. Manuel Pérez, 2013/2014), substantially similar to this bill, would have created a California New Markets Tax Credit Program. AB 1399 did not pass by the constitutional deadline.

**PROGRAM BACKGROUND**

None noted.

**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*

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1572 as Amended January 3, 2022.  
Assumed Enactment after June 30, 2022

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2022-2023	\$0
2023-2024	-\$6.5
2024-2025	-\$16

This estimate assumes specific appropriations of funds are made beginning in fiscal years 2023-2024 through 2028-2029.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**LEGAL IMPACT**

None noted.

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## **APPOINTMENTS**

None noted.

## **SUPPORT/OPPOSITION**

According to the committee analysis dated January 7, 2022:

### *Support*

- California Asian Pacific Chamber of Commerce
- California Association for Micro Enterprise Opportunity
- California Chamber of Commerce
- California Hispanic Chambers of Commerce
- Coalition of Small and Disabled Veteran Businesses
- Flasher Barricade Association
- Small Business Majority

### *Opposition*

None on file.

## **ARGUMENTS**

None on file.

## **LEGISLATIVE CONTACT**

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