



Bill Analysis

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

Sponsor:

Related Bills: See Legislative
History

Bill Number: AB 1572

Introduced: March 4, 2021

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

Not applicable.

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.

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ANALYSIS

California New Markets Tax Credit

For taxable years beginning on or after January 1, 2023, and before January 1, 2028, 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.
- 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.

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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 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 California New Market Tax credit would only be allocated by GO-Biz for taxable years in which moneys are appropriated to GO-Biz for administration. The appropriation would be required to specifically identify the California New Markets Tax Credit. 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.
- In consultation with the FTB, establish a process for recapture of the credit. Recaptured investments would revert back to GO-Biz to be reissued and such 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.

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For the credit allocation application process, GO-Biz would be required to accept applications on or before October 15, 2022, and award authority to designated qualified equity investments annually through 2027.

The qualified community development entity 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.

Failure to meet these requirements would result in the lapse of the certification and lapsed certifications would revert back to GO-Biz.

The qualified community development entity must also:

- Provide GO-Biz with the names 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.

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 would be subject to the same rules, requirements, and limitations applicable to the transferor.

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 application and reporting of the qualified community development entity.

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The credit would be repealed by its own terms as of December 1, 2028.

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.

This bill, in compliance with Revenue & Taxation Code (RTC) section 41, would provide specific goals, purposes, and objectives of the California New Markets Tax Credit Program. The data to collect would include the following:

- 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, 2023, and before January 1, 2028, subject to a specific appropriation for the 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).

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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.

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

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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.

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.

Under RTC section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit.

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.

In the event of a dispute regarding the recapture process, there is no legislative authority for the FTB to disclose taxpayer information to GO-Biz. State law prohibits the disclosure of any taxpayer information except as specifically authorized by statute. The bill should be amended to include specific authority to allow the FTB to disclose this information to GO-Biz.

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This credit would only be operative with a future appropriation for GO-Biz. It is unclear how the department would implement this credit without a sufficiently clear and timely appropriation. For clarity and ease of administration, it is recommended that this bill be amended.

For clarity, the bill should be amended to specify that GO-Biz would be responsible for the collection of data and reporting to satisfy the Section 41 reporting requirement.

GO-Biz would receive from qualified community development entities the names of taxpayers eligible to use the tax credit. For clarity and ease of administration, it is recommended that the bill be amended to require the qualified community development entities to also provide GO-Biz with the taxpayers' addresses and social security numbers or individual taxpayer identification numbers and that this information be provided to the FTB by GO-Biz.

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.

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 recommended that the phrase "any rules or" be removed where it appears in this bill.

The bill includes duplicate language regarding recaptured credits not counting against the annual or the cumulative limit. It is recommended that the duplicate language included on page 6, starting on line 30 ("Reallocated qualified equity investments attributable to recaptured credits shall not count against the annual or cumulative limit."), be deleted.

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.

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While this bill would prohibit taxpayers claiming the California New Markets Tax Credit from claiming otherwise allowable credits for the same investment, it would not prohibit taxpayers from claiming deductions for the same investment. If this is in contrast with the author's intent, 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 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 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 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.

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 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.

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.

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 Introduced March 4, 2021
Assumed Enactment after June 30, 2021

(\$ in Millions)

Fiscal Year	Revenue
2021-2022	\$0
2022-2023	-\$6.4
2023-2024	-\$15

This estimate assumes specific appropriations of funds are made beginning in fiscal years 2022-2023 through 2026-2027.

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.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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