# HOUSE BILL REPORT
# HB 3175

**As Reported by House Committee On:**
Community & Economic Development & Trade

**Title:** An act relating to business and occupation tax incentives to encourage investment in qualified community development entities.

**Brief Description:** Providing business and occupation tax incentives to encourage investment in qualified community development entities.

**Sponsors:** Representatives Conway, Pettigrew, Chase, Linville, Hasegawa, Fromhold, Sullivan, Skinner, Roach, McIntire, Condotta, Orcutt, Morrell, Ericks, Kelley, Dunn, Kenney, Santos and Ormsby.

**Brief History:**

**Committee Activity:**

Community & Economic Development & Trade: 2/4/08, 2/5/08 [DPS].

**Brief Summary of Substitute Bill**

- Creates the Washington State New Markets Development (NMD) Program, which allows, until December 31, 2013, a tax credit against the business and occupation tax for qualified investments benefitting low-income community businesses, up to $15 million in total NMD Program tax credits in a fiscal year.

## HOUSE COMMITTEE ON COMMUNITY & ECONOMIC DEVELOPMENT & TRADE

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Kenney, Chair; Pettigrew, Vice Chair; Bailey, Ranking Minority Member; McDonald, Assistant Ranking Minority Member; Chase, Darneille, Haler, Rolfes and Sullivan.

**Staff:** Chris Cordes (786-7103).

**Background:**

Federal New Markets Tax Credit Program

*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

The federal Community Renewal Tax Relief Act of 2000 authorized tax credits against federal income taxes for up to $15 billion in investments under the U.S. Treasury Department's New Markets Tax Credits (NMTC) Program. Since then, the U.S. Congress has authorized additional NMTC Program tax credit authority. The purpose of the NMTC Program is to stimulate capital investment in low-income and economically distressed areas through Community Development Entities (CDEs). The NMTC Program is administered through the federal Community Development Financial Institutions Fund of the U.S. Treasury Department.

A CDE is a domestic corporation or partnership, created or controlled by a public, private, or nonprofit entity, that has a primary mission of serving and providing investment capital in low-income communities. A CDE must maintain accountability to residents of low-income communities through their representation on a governing or an advisory board, and must be certified as a CDE by the U.S. Treasury.

Certified CDEs are eligible to compete nationally for an allocation of NMTCs, and if successful, may offer taxpayers who make qualified equity investments in the CDE a federal income tax credit equal to 39 percent of the cost of the investment. The tax credit is claimed over a seven-year period, with a maximum credit of 5 percent in each of the first three years and 6 percent in each of the last four years. An investor may not redeem the investment in CDEs before the end of the seven-year period. According to a Government Accountability Office (GAO) report issued in January 2007, the largest proportion of NMTC investors were banks and individuals, although banks and corporations have made the largest share of NMTC investment.

The CDE must use the investment for community development projects in low-income or economically distressed areas. With the tax credits, investors are able to provide low-cost financing to local project developers, including grants and below-market-rate loans. The 2007 GAO report determined that most investment has been used for either commercial real estate rehabilitation or new commercial real estate construction. Examples of investment projects include rehabilitation of vacant buildings into housing, hotels, commercial offices, or spaces for the arts, and construction of new buildings for use by nonprofit organizations.

The 2007 GAO report showed that as of January 2007, 233 NMTC allocation awards had been made for a total of $12.1 billion in allocation authority, which was used to attract nearly $5.3 billion in NMTC investment. The total amount invested by these CDEs had grown from about $140 million per year in 2003 to $2.2 billion in 2005.

For calendar year 2008, the federal government will allocate tax credits to CDEs nationwide for $3.5 billion in investments.

<u>New Markets Tax Credit Programs in Other States</u>

Three states, Missouri, Louisiana, and Mississippi, have state NMTC programs that provide tax credits against the state income tax, similar to the federal NMTC program. The percent of tax credit permitted in each state for each of the seven tax credit years varies. In Missouri, for example, no credit is allowed for the first two years, the third year's tax credit is 7 percent, and the tax credit in the remaining four years is 8 percent.

Washington Business and Occupation (B&O) Tax

Washington's major business tax is the business and occupation (B&O) tax. This tax is imposed on the gross receipts of business activities conducted within the state. There are a number of different rates, and a business may have more than one B&O tax rate, depending on the types of activities conducted. The tax rate for most types of businesses that provide services is 1.5 percent.

The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. However, there are exemptions for specific types of business activities, and certain deductions and credits are permitted.

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**Summary of Substitute Bill:**

The Washington State New Markets Development Program (NMD Program) is created. Under the NMD Program, a taxpayer that makes a qualified investment benefitting a low-income community business is provided a tax credit against its B&O tax. The NMD Program expires December 31, 2013.

*Tax Credit Cap.* The total of NMD Program tax credits that may be taken in a fiscal year is limited to $15 million. The Department of Revenue (DOR) must allocate the tax credits on a first-come, first-served basis.

*Who Qualifies for the Tax Credit.* The NMD Program tax credit is available to a taxpayer that makes a qualified equity investment. A "qualified equity investment" is an equity investment in, or long-term security issued by, a qualified community development entity. The investment must be acquired after the bill's effective date in exchange for cash, and at least 85 percent of the cash must be used to make qualified low-income community investments. No qualified active low-income community business may receive more than $10 million in financing from these investments.

A "qualified community development entity" is an entity that has an allocation agreement with the federal Community Development Financial Institutions Fund which includes Washington within the service area of the allocation.

A "qualified active low-income community business" is one that, among other criteria, derives at least 50 percent of its gross income from a qualified business in a low-income community. However, a business is not qualified if it derives 15 percent or more of its revenue from the rental or sale of real estate.

*Tax Credit Amount.* The NMD Program tax credit is a percentage of the purchase price paid to the issuer of the investment (or of the relevant share of the purchase price invested in Washington), which may not exceed the taxpayer's tax liability for that year. The applicable percentage to calculate the tax credit is 0 percent for the first two years, 12 percent for the third and fourth years, and 15 percent for the fifth year.

Unused tax credits may be carried forward to any of the taxpayer's five subsequent taxable years. Tax credits are not refundable or saleable on the open market.

*Recapture of Tax Credits.* Recapture of claimed tax credits is required if any amount of the federal NMTC is recaptured under federal law. The state recapture must be proportionate to the federal recapture. A proportionate state recapture of claimed tax credits is also required if the issuer redeems or makes principal repayment before the seventh anniversary of the investment issuance, unless the funds are reinvested in another qualifying investment within 12 months.

*Rules.* The DOR may adopt rules to implement the NMD Program.

*Report.* Taxpayers claiming the NMD Program tax credit must file a survey with the DOR by July 1, 2013, with information about the tax credits taken, the projects invested in, and employment positions created. The DOR must report to the Legislature on the tax credit program by December 1, 2013.

**Substitute Bill Compared to Original Bill:**

The substitute bill adds that: (1) taxpayers claiming the New Markets Development Program B&O tax credit must file returns in an electronic format; (2) taxpayers claiming the tax credit must provide information to the DOR for a report to the Legislature on the tax credit program; and (3) the DOR must make the report by December 1, 2013, including information on tax credits claimed, projects invested in, job creation in low-income community businesses, and the impact on growth of low-income community businesses.

The substitute bill changes the bill's expiration date from July 1, 2012, to December 31, 2013.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Staff Summary of Public Testimony:**

(In support) The federal New Markets Tax Credit Program has resulted in billions invested in low-income businesses. It targets the low-income communities that need investment capital the most. Attracting this private investment is very important, especially when, as now, capital is difficult to get. Investors have options about where to invest that money, and only 3 percent is being invested in Washington. This bill is patterned after laws in three states that have created a state-level program that would remain in effect even if the federal program was not reauthorized. The community development organizations have to be qualified under federal law. A study done by a Clemson University professor showed that the accumulated gains from economic development are greater than the revenue losses for these programs. The program would help grow businesses in these communities, would help to buffer hard economic times, and would address the lack of capital availability. The approach used in this bill is unique because it focuses on investment in operations, not on real estate development.

(Opposed) None.

**Persons Testifying:** Lincoln Ferris, Coalition for Investing in Washington Jobs; and Cos Roberts and Glenn Gregory, Tabor 100.

**Persons Signed In To Testify But Not Testifying:** None.