HOUSE BILL REPORT
HB 3174

As Reported by House Committee On:
Insurance, Financial Services & Consumer Protection

Title: An act relating to incentives for financial institutions to encourage investment in qualified community development entities.

Brief Description: Providing incentives for financial institutions to encourage investment in qualified community development entities.

Sponsors: Representatives Kirby, Haler, Chase, Linville, Hasegawa, Fromhold, Sullivan, Pettigrew, Skinner, Roach, Orcutt, Morrell, Ericks, Kelley, Dunn, Kenney, Santos and Ormsby.

Brief History:

Committee Activity:

Insurance, Financial Services & Consumer Protection: 1/31/08 [DP].

Brief Summary of Bill

- Creates the Washington State New Markets Development (NMD) Program, which allows 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 INSURANCE, FINANCIAL SERVICES & CONSUMER PROTECTION

Majority Report: Do pass. Signed by 9 members: Representatives Kirby, Chair; Kelley, Vice Chair; Roach, Ranking Minority Member; Hurst, Loomis, Rodne, Santos, Simpson and Smith.

Staff: Alison Hellberg (786-7152).

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 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 tax credit authority and extended the NMTC. 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 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 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 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.

Summary of Bill:

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

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 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.

Appropriation: None.

Fiscal Note: Requested on January 27, 2008.

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

Staff Summary of Public Testimony:

(In support) This bill tries to address the issue of lack of capital investment in low-income communities. It requires that the investment stay in the community for at least seven years or all of the money must be returned.

The federal version of this program is the largest economic development program targeted at low-income communities. Washington only gets a small percentage of the funds of the federal NMD Program. This would help raise Washington's participation. The federal legislation has been focused on real estate, this would focus on other types of businesses and be a compliment to the federal NMD Program.

This is a good bill that drives money to the communities that need it. It is a good bill, but could use some improvements. First, would be to add insurers and a premium tax credit, like the Senate version (SB 6752). The bill is also missing a piece about it being limited to Washington domiciled businesses, this should also be included.

(Opposed) None.

Persons Testifying: Lincoln Ferris, Coalition for Investing in Washington Jobs; Ryan Brennan, Advantage Capital; and Gary Stronnigan, Safeco.

Persons Signed In To Testify But Not Testifying: None.