

# HOUSE BILL REPORT

## HB 1324

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**As Reported by House Committee On:**  
Rural Development, Agriculture, & Natural Resources

**Title:** An act relating to creating the Washington rural development and opportunity zone act.

**Brief Description:** Creating the Washington rural development and opportunity zone act.

**Sponsors:** Representatives Chapman, Maycumber, Springer, Chandler, Blake, Stokesbary, Steele, Reeves, Pettigrew, Dolan, Volz, Barkis, Eslick, Lekanoff, Tharinger, Hoff, Jinkins, Kilduff and Leavitt.

**Brief History:**

**Committee Activity:**

Rural Development, Agriculture, & Natural Resources: 1/30/19, 2/6/19 [DPS].

**Brief Summary of Substitute Bill**

- Creates a program to develop rural and opportunity zone areas.
- Creates a tax preference for taxpayers who make a capital contribution to a Rural Development and Opportunity Zone Fund.
- Extends a reduced business and occupation tax rate on certain timber-related activities.

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### HOUSE COMMITTEE ON RURAL DEVELOPMENT, AGRICULTURE, & NATURAL RESOURCES

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 13 members: Representatives Blake, Chair; Shewmake, Vice Chair; Chandler, Ranking Minority Member; Dent, Assistant Ranking Minority Member; Chapman, Dye, Fitzgibbon, Lekanoff, Orcutt, Pettigrew, Ramos, Schmick and Walsh.

**Staff:** Robert Hatfield (786-7117).

**Background:**

Opportunity Zones.

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*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.*

Opportunity zones were created through the federal Tax Cuts and Jobs Act, signed into law on December 22, 2017. The definition of qualified opportunity zones is codified in the Internal Revenue Code at 26 U.S.C. 1400Z-1. Investors are able to defer paying taxes on capital gains that are invested in qualified opportunity funds that in turn are invested in distressed communities designated as opportunity zones by the governor of each state. To qualify for opportunity zone status, a census tract must have an individual poverty rate of at least 20 percent and median family income of up to 80 percent of the area median. Up to 25 percent of the low-income census tracts in each state can be designated as opportunity zones. A total of 555 census tracts in Washington meet these eligibility criteria. In 2018 Governor Inslee approved 139 census tracts in 36 counties for opportunity zone status.

#### Rural Business Investment Companies.

The United States Department of Agriculture (USDA) operates a Rural Investment Program whose aim is to promote economic development, and to provide a means to meet the equity capital investment needs of primarily smaller enterprises located in rural areas. The USDA licenses Rural Business Investment Companies through the Rural Investment Program.

#### Small Business Investment Companies.

The United States Small Business Administration (SBA) operates the Small Business Investment Company (SBIC) Program, which was established to increase access to capital for growth stage businesses. Through the SBIC Program, privately owned and managed investment funds are licensed and regulated by the SBA.

#### Insurance Premium and Retaliatory Taxes.

Insurers operating in Washington pay a variety of fees and taxes, including the insurance premium tax and, in some cases, retaliatory taxes.

##### *Insurance Premium Tax.*

The insurance premium tax is levied on net premiums collected or received by authorized insurers, except title insurers and fraternal benefit societies, and in lieu of the business and occupation (B&O) tax. However, insurance companies do pay B&O tax on income derived from any other activities in which they engage. With some exceptions, authorized insurers are subject to a 2 percent insurance premium tax.

##### *Retaliatory Taxes.*

Washington imposes a higher tax rate on an insurer domiciled in another state or country if the state or country charges a higher tax rate on Washington-based insurance companies doing business in its jurisdiction. An alien insurer is domiciled in the state where it has established its principal office or agency, or in the country in which its laws are formed.

#### Business and Occupation Taxes.

Washington's major business tax is the B&O tax. The B&O tax is imposed on the gross receipts of all taxable business activities conducted within the state, unless otherwise exempt. There is no deduction for the costs of doing business. Revenues are deposited into the State General Fund. There are several rate categories and a business may be subject to more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are: 0.471 percent for retailing; 0.484 percent for manufacturing, wholesaling, and extracting; and 1.5 percent for services and for activities not classified elsewhere. Several preferential rates

also apply to specific business activities. Business and occupation taxes are collected by the Department of Revenue.

Business and Occupation Taxes—Timber Products.

In 2006 B&O tax rate reductions were provided for the timber industry. The B&O tax rate was reduced for the activities of extracting timber or extracting for hire timber, or manufacturing or processing for hire logs, wood chips, sawdust, wood waste, pulp, recycled paper products, paper and paper products, dimensional lumber, and engineered wood products, plywood, wood doors, and wood windows. The lower B&O tax rate also applies to the sale of standing timber. The B&O tax rate for these activities is 0.2904 percent. The reduced tax rate expires July 1, 2024.

Tax Preference Performance Statement and Expiration Date.

All new tax preference legislation must include a tax preference performance statement, unless exempted. Tax preferences include deductions, exemptions, preferential tax rates, and tax credits. The performance statement must clearly specify the public policy objectives of the tax preference, and the specific metrics and data that will be used by the Joint Legislative Audit and Review Committee to evaluate the efficacy of the tax preference.

New tax preferences expire 10 years after the effective date of the tax preference, unless otherwise provided.

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**Summary of Substitute Bill:**

The Washington Rural Development and Opportunity Zone Act is established for the stated purpose of creating and retaining jobs in rural and opportunity zone areas of Washington.

Definitions.

Various terms associated with the Washington Rural Development and Opportunity Zone Program (Program) are defined, including:

- "Closing date" means the date on which a Rural Development and Opportunity Zone Fund (Fund) has collected from investors all of the amounts required under the Program.
- "Credit-eligible capital contribution" means an investment of cash by a person subject to either insurance premium taxes or business and occupation (B&O) taxes in a Fund that equals the amount specified on a tax credit certificate issued by the Department of Commerce (Commerce).
- "Investment authority" means the amount stated on a written approval issued by Commerce. At least 60 percent of a Fund's investment authority must be composed of credit-eligible capital contributions.
- "Qualified area" means either: (a) a county with a population density of less than 100 persons per square mile or a county smaller than 225 square miles, as determined by the Office of Financial Management; or (b) a qualified opportunity zone as defined by 26 U.S.C. 1400Z-1 of the Internal Revenue Code.
- "Targeted small business" means a business that: has fewer than 250 employees and not more than \$10 million in net income for the preceding year; has its principal

business operations in one or more qualified areas in the state; and is engaged in certain specified industries or, if it is not engaged in such industries, Commerce makes a determination that the investment will be highly beneficial to the economic growth of the state.

#### Tax Credit Application and Approval.

Beginning January 1, 2020, Commerce must accept applications for approval as a Fund. An application must contain the following elements:

- the total amount of investment authority sought by the applicant;
- a copy of the applicant's, or an affiliate of the applicant's, license as a Rural Business Investment Company or as a Small Business Investment Company;
- evidence that, as of the date of the application, the applicant or the affiliates of the applicant have invested at least \$150 million in nonpublic companies located in areas within or without Washington that would be qualified areas if in Washington;
- an estimate of the number of jobs that will be created or retained in Washington as a result of the applicant's growth investments, and the assumptions used to determine the estimate;
- a business plan that includes a revenue impact assessment projecting state and local tax revenue to be generated by the applicant's proposed growth investments, prepared by a nationally recognized third-party independent economic forecasting firm using a dynamic economic forecasting model that analyzes the applicant's business plan over the 10 years following the date of the application;
- a signed affidavit from each investor stating the amount of credit-eligible capital contributions each taxpayer commits to make, and whether the taxpayer plans to apply the tax credit against B&O taxes or against insurance premium taxes; and
- a nonrefundable application fee of \$5,000.

For the overall Program, Commerce may not approve more than \$100 million in total statewide investment authority, and may not approve more than \$60 million in credit-eligible capital contributions. If requests for investment authority exceed \$100 million, Commerce must proportionally reduce the investment authority and credit-eligible capital contributions for each approved application as necessary in order to avoid exceeding the limit.

For each Fund applicant, Commerce may not approve more than \$35 million in total statewide investment authority, and not more than \$21 million in credit-eligible capital contributions per applicant. If fewer than three applicants have been approved as a Fund by November 1, 2020, a Fund may apply for additional investment authority and capital contributions in excess of the per-applicant limit.

The Department of Commerce must deny an application for certain specified reasons, including that the applicant does not satisfy specified criteria, and that the revenue impact statement submitted by the applicant does not demonstrate that the applicant's business plan will result in a positive economic impact on aggregate state and local government revenue under a 10 year period that exceeds the cumulative amount of tax credits that would be issued to the applicant's investors. The Department of Commerce may not deny an application for other than the specified reasons.

Upon approval of an application, Commerce must provide a written approval to the applicant as a Fund, specifying the amount of the applicant's investment authority.

After receiving a written approval, the Fund must collect credit-eligible capital contributions from each investor and collect one or more investments of cash that, when added to the credit-eligible capital contributions, equal the Fund's investment authority.

Upon receiving documentation from a Fund that it is fully funded, Commerce must issue a tax credit certificate to each investor whose affidavit was included in the application, specifying the amount of the investor's credit-eligible contribution. The Department of Commerce must also provide a copy of the tax credit certificate to the Office of the Insurance Commissioner for investors earning tax credits eligible for use against insurance premium taxes, and to the Department of Revenue (Revenue) for investors earning tax credits eligible for use against B&O taxes. The tax credit certificate must include the credit-eligible capital contribution amount, the name of the Fund, the unified business identifier number of the investor, and the closing date of the Fund.

Tax credits may be transferred or allocated to an affiliate of the taxpayer if certain requirements are met.

#### Rural Development and Opportunity Zone Account.

The Rural Development and Opportunity Zone Account (Account) is created in the State Treasury. All receipts from application fees for the Program must be deposited into the Account. Moneys in the Account may be spent only after appropriation. Expenditures from the Account may be used by Commerce only for administering the Program.

#### Insurance Premium Tax and Business & Occupation Tax Credit.

A tax credit is authorized against B&O and B&O taxes otherwise due, or insurance premium taxes otherwise due, including the retaliatory provision, for persons that made a credit-eligible capital contribution to a Fund and were issued a tax credit certificate. The credit is earned on the closing date noted on the tax credit certificate. The credit is equal to the amount of the taxpayer's credit-eligible capital contribution to the Fund.

The taxpayer may claim up to one-third of the credit for each of the calendar years that include the fourth through sixth anniversaries of the closing date noted on the tax credit certificate. The amount of credit claimed for a tax reporting period may not exceed the amount of tax otherwise due for that reporting period. Unused credits may be carried forward until used, even if claimed after the Program expires. No refunds may be granted for tax credits under the Program.

The credit may not be transferred or allocated to any other entity other than an affiliate subject to the B&O tax or insurance premium tax, including the retaliatory provision.

#### Revocation of Tax Credit Certificates.

The Department of Commerce must revoke a tax credit certificate if any of the following occur before a Fund properly exits the Program:

- the Fund does not invest 75 percent of its investment authority in growth investments in the state within two years of the closing date, and 100 percent of its investment authority in growth investments in the state within three years of the closing date;
- the Fund, after satisfying the initial investment requirement above, fails to maintain growth investments equal to 100 percent of its investment authority until the sixth anniversary of the closing date;
- the Fund, before properly exiting the Program, makes a distribution or payment that results in the Fund having less than 100 percent of its investment authority invested in growth investments in the state or available for investment in growth investments and held in cash and other marketable securities;
- the Fund invests more than the greater of \$5 million or 20 percent of its investment authority in the same targeted small business, including affiliates of the targeted small business; or
- the Fund makes a growth investment in a targeted small business that has certain specified financial relationships with the Fund or with affiliates of or investors in the Fund. This requirement does not apply to publicly traded securities by a targeted small business.

Before revoking a tax certificate, Commerce must notify the Fund of the reasons for the pending revocation. The Fund has 90 days to correct any violations outlined in the notice.

If a tax credit certificate is revoked, the investment authority and credit-eligible capital contributions associated with the revoked certificate do not count toward the overall limit on total investment authority and credit-eligible capital contributions. In case of a revocation, Commerce must first award reverted investment authority, on a pro rata basis, to each Fund that was awarded less than its requested investment authority. The Department of Commerce may award any remaining investment authority to new applicants.

#### Request for Determination.

A Fund, before making an investment, may request from Commerce a written opinion as to whether the business in which it proposes to invest is a targeted small business. The Department of Commerce must notify the Fund of its determination within 15 business days. If Commerce fails to notify the Fund of its determination by the fifteenth business day, the business in which the Fund proposes to invest must be considered a targeted small business.

#### Exit from the Program.

On or after the sixth anniversary of the closing date, a Fund may apply to Commerce to exit the Program. The Department of Commerce must respond to the application within 30 days of receipt of the application. The fact that no tax credit certificates have been revoked, and that the Fund has not received a notice of revocation that has not been cured, is sufficient evidence to prove that the Fund is eligible for exit.

The Department of Commerce may not unreasonably deny an application to exit the Program. If the exit application is denied, the notice of denial must include the reasons for the denial.

The Department of Commerce must notify the Office of the Insurance Commissioner and Revenue when a Fund exits the Program.

The Department of Commerce may not revoke a tax credit certificate after a Fund exits the Program.

Job Creation and Retention–Repayment.

Before Commerce may approve the exit of a Rural Development and Opportunity Fund (Fund) from the Program, Commerce must evaluate the number of jobs created or retained by the Fund, and determine whether the Fund must repay to the state any portion of the tax credit as follows:

- If the number of jobs created or retained as a result of the Fund's investments is less than 60 percent of the number filed as part of the Fund's application, the Fund must repay to the state 60 percent of the amount of the tax credit certificates issued to the Fund.
- If the number of jobs created or retained as a result of the Fund's investments is less than 80 percent but more than 60 percent of the number filed as part of the Fund's application, the Fund must repay to the state 30 percent of the amount of the tax credit certificates issued to the Fund.

In measuring jobs created and retained as a result of the Fund's growth investments, Commerce must prorate the number of jobs set forth in the Fund's business plan based on the amount of investment authority requested in the Fund's application.

The Department of Commerce must provide written notice to the Fund of any repayment due. The Fund must submit payment to Revenue within 30 days of that notice. If the Fund fails to pay the full amount by the due date in the notice or in any extension granted by Revenue, Revenue must impose penalties and interest.

Local and State Tax Revenue–Repayment.

Before Commerce may approve the exit of a Fund from the Program, Commerce must evaluate the aggregate state and local government revenues generated by growth investments made pursuant to, or related to, the Fund's participation in the Program, and determine whether the Fund must repay to the state any portion of the credit as described below.

If the amount of aggregate state and local government revenue generated by growth investments made pursuant to, or related to, the Fund's participation in the Program is less than the cumulative amount of tax credits that were issued to the Fund's investors, the Fund must repay to the state 100 percent of the difference between the cumulative amount of tax credits that were issued to the Fund's investors and the actual aggregate state and local government revenues generated by growth investments made pursuant to, or related to, the Fund's participation in the Program.

The actual aggregate state and local government revenues generated by growth investments made pursuant to, or related to, the Fund's participation in the Program must be calculated by Commerce using a dynamic economic forecasting model that analyzes the Fund's growth investments made pursuant to, or related to, the Fund's participation in the Program.

The term "growth investments made pursuant to, or related to, the Fund's participation in the Program" means those investments made by the Fund in targeted small businesses in

qualified areas as part of the Fund's investment authority under the Program, as well as any additional investments the Fund may also make in those targeted small businesses in qualified areas using sources of capital not included within the Fund's investment authority under the Program.

#### Reporting Obligations.

Each Fund must submit a report to Commerce each year. The report must include:

- a bank statement evidencing each growth investment;
- the name and location of principal operations;
- the industry North American Industry Classification System code of each business receiving a growth investment;
- the number of jobs created or retained as a result of the Fund's growth investments, and the assumptions used to determine the number of employment positions;
- the average annual salary of the jobs created or retained; and
- any other information required by Commerce.

#### Department of Commerce–Rulemaking and Reporting.

The Department of Commerce is authorized to adopt rules to implement the Program.

The Department of Commerce is required to submit an annual report to the committees of the Legislature with jurisdiction over economic development. The report must include: the names of approved applicants; the amount and type of credit allocated to investors in the Fund; the criteria used to select applicants approved for tax credits; and certain other information provided in the annual report submitted by each Fund.

#### Tax Preference Performance Statement.

The stated intent of the Legislature is to provide a vested tax credit that may be used to offset certain B&O taxes and insurance premium taxes in order to induce such taxpayers to invest in Funds whose management teams meet certain specified criteria.

The stated intent of the Legislature is to continue the tax preferences beyond their current expiration in 2025 if the Joint Legislative Audit and Review Committee finds that the aggregate number of jobs created or retained matches or exceeds the aggregate number of jobs set forth in the business plans of approved Funds in the six years following the enactment of the tax preferences.

#### Timber Product Business and Occupation Tax Extension.

The expiration date of the reduced B&O tax rate associated with certain timber products is extended from July 1, 2024, to July 1, 2056. The timber products tax rate for the period July 1, 2024, through June 30, 2056, is 0.2384 percent. The expiration date of the timber products surcharge is extended from June 30, 2024, to June 30, 2056. The circumstances in which the timber products surcharge may be adjusted or eliminated are removed. The extension of the reduced tax rate is exempted from the requirement to include a tax preference performance statement.

#### **Substitute Bill Compared to Original Bill:**



A requirement is added that, when a Rural Development and Opportunity Zone Fund (Fund) applies to exit the Rural Development and Opportunity Zone Program, if the actual local and state tax revenues generated by the Fund's investments are less than the cumulative amount of tax credits sold by that Fund, the Fund must repay the state the full amount of the difference.

The date on which the Department of Commerce (Commerce) must begin accepting applications is changed from November 1, 2019, to January 1, 2020. The date on which Commerce must submit its first report to the Legislature is changed from November 1, 2019, to January 1, 2020.

The rate of the timber-related activities business and occupation tax between July 1, 2024, and June 30, 2056, is modified from 0.2904 percent to 0.2384 percent. The extension of the timber products surcharge is added. The circumstances in which the timber products surcharge may be adjusted or eliminated are removed.

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**Appropriation:** None.

**Fiscal Note:** Available.

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

**Staff Summary of Public Testimony:**

(In support) The Rural Development and Opportunity Zone Program (Program) in the bill will free up capital for investment. Access to capital can sometimes be the limiting factor in expanding rural communities. Under the bill, small businesses will get help to build a good business plan. The current tax rate for the pulp and paper industry will expire in 2024. It was part of the original Forest and Fish Agreement. One mill in Port Angeles is deciding whether to reopen, which would potentially add 200 good-paying jobs. With the potential expiration of the tax rate, the company is struggling with how much they can invest. Extending the business and occupation tax rate for timber products would represent a generational commitment from the Legislature to the importance of the timber industry.

The bill creates a private investment fund for small and medium-sized companies who are looking to expand. The bill is a step forward to providing resources to incentivize development. The Program in the bill would improve job growth and attract capital to rural areas. It would allow businesses to expand in underserved areas.

Many businesses are having problems in rural areas, particularly with access to capital. The bill has several taxpayer protections.

The best way for a banker to take care of clients is to provide them with access to capital. Capital investments generate roughly \$250 million in direct economic impacts from one banker's clients. Sometimes clients have to change the way they do business, and in that

case, it is riskier for the bank to loan that client money, and the bank looks at other ways of getting capital to clients. This bill represents another way of getting capital to clients.

The Program in the bill is not in competition with banks. If a small business can get a loan from a bank, they should. But under the new lending restrictions, a small business often cannot get the entire amount they need. Certain investment companies can fill that gap. There may be some concern about this being a tax credit. The bill is attempting to build in protections that keep the state whole. There are two strong provisions that protect the state. If a Fund does not produce the jobs it said it would, the Fund has to write a check back to the state of Washington. If a project does not generate an equivalent amount of revenue as was taken in tax credits, the Fund has to write a check back to the state of Washington.

(Opposed) None.

**Persons Testifying:** Representative Chapman; prime sponsor; Dru Garson, Greater Grays Harbor Incorporated; Mike Ennis, Association of Washington Business; Andrew Mesojednik, Bank of the Pacific; Steve Gano, Advantage Capital; and Tom Nelson, Sierra Pacific Industries.

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