

# SENATE BILL REPORT

## SB 5423

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As Reported by Senate Committee On:  
Financial Institutions, Economic Development & Trade, January 31, 2019

**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:** Senators Palumbo, Warnick, Hobbs, Takko, Schoesler, Sheldon, King, Brown, Short, Wilson, L., Wagoner, Wellman, Honeyford and Van De Wege.

**Brief History:**

**Committee Activity:** Financial Institutions, Economic Development & Trade: 1/24/19, 1/31/19 [DPS-WM, w/oRec].

**Brief Summary of First Substitute Bill**

- Creates rural development and opportunity zone funds.
- Extends a reduced business and occupation tax on certain timber activities.

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**SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, ECONOMIC DEVELOPMENT & TRADE**

**Majority Report:** That Substitute Senate Bill No. 5423 be substituted therefor, and the substitute bill do pass and be referred to Committee on Ways & Means.

Signed by Senators Mullet, Chair; Wilson, L., Ranking Member; Braun, Das and Hobbs.

**Minority Report:** That it be referred without recommendation.

Signed by Senator Hasegawa, Vice Chair.

**Staff:** Kellee Gunn (786-7429)

**Background:** Rural and Small Business Investment Companies. Rural Business Investment Companies (RBIC) and Small Business Investment Companies (SBIC) are privately owned and managed investment funds, licensed and regulated by the United States Department of Agriculture (USDA) and the Small Business Administration (SBA), respectively. Both allow for capital investments in small businesses and smaller enterprises located in rural areas.

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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.*

Both RBICs and SBICs raise private capital from investors and may receive borrowed capital from the USDA or SBA, respectively, in order to fund the investments.

An RBIC or SBIC program is a provision in a state or federal tax code that offers incentives for private capital to invest in small businesses, startups, low-income areas, or regions otherwise under economic distress. These programs often include special criteria for a certain quantity of the credit to focus on rural or underdeveloped areas.

Opportunity Zones. Opportunity zones were created through the federal Tax Cuts and Jobs Act, signed into law on December 22, 2017. The governor of every state may designate up to 25 percent of eligible census tracts as opportunity zones. To qualify as an opportunity zone, a census tract must have an individual poverty rate of at least 20 percent and median family income up to 80 percent of the area median. In April of 2018, 139 census tracts became opportunity zones out of the 555 that qualified.

Business and Occupation Tax Rate on Timber Activities. On July 1, 2007, the business and occupation (B&O) tax rate was reduced to .003424 for certain activities related to the timber industry including:

- sales of standing timber;
- extracting or extracting for hire timber;
- manufacturing or processing for hire timber into timber, wood, or other products; and
- selling certain timber and wood products at wholesale.

This reduced B&O tax rate will expire June 30, 2024.

**Summary of Bill (First Substitute):** Eligible Areas. A person may contribute into rural development and opportunity zone funds (Fund) for the purpose of creating and retaining jobs in qualified areas of Washington.

A qualified area is either:

- 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 (OFM); or
- a qualified opportunity zone as defined by the Tax Cuts and Jobs Act.

According to 2018 population density data from OFM, all counties except for Benton, Clark, King, Kitsap, Pierce, Snohomish, Spokane, Thurston, and Whatcom would qualify. However, other areas may meet the eligibility of being an opportunity zone and thus a qualified area.

Contributions to the Fund. The credit-eligible capital contribution (contribution) into the Fund must be a cash investment, which the Department of Commerce (Commerce) has verified and provided the investor with a tax credit certificate (certificate). The certificate indicates the Fund is fully funded. Commerce would then provide copies of the certificate to the Office of the Insurance Commissioner (OIC) and the Department of Revenue (DOR) for investors who are earning tax credits for either their insurance premiums taxes, or their B&O taxes. The certificate must include certain information regarding the amount invested, the investor, and the Fund.

Limits in Contribution to the Fund. Commerce may not approve more than a total of \$100 million in investment authority and no more than \$60 million in contributions for a Fund and a single applicant is limited to no more than \$35 million in investment authority and no more than \$21 million in contributions. If fewer than three applicants are approved by November 1, 2020, a Fund may apply for additional investment authority and capital contributions in excess of the limits.

Tax Credits. Insurance premium tax or B&O tax credits or both are earned on the closing date of the Fund and are equal to the contribution made. Up to one-third of the credit may be claimed for the fourth through sixth anniversaries of the closing date noted on the certificate, exclusive of amounts carried forward from prior years. The amount claimed for a tax reporting period may not exceed the amount of tax otherwise due and unused credits may be carried forward until used. Anyone claiming the credit must file electronically with either the OIC or DOR. Commerce must provide the OIC or DOR information if the status of the tax credit changes. No refunds may be granted for credits.

Tax credits may be transferred, or allocated, to an affiliate of the taxpayer, with verification from Commerce. An amended certificate will then be sent by Commerce to appropriate parties as well as to the OIC and DOR.

A taxpayer receiving a B&O credit must file a complete annual tax performance report with DOR.

*Revoking Tax Credit Certificates.* Revocation of a certificate occurs when:

- the Fund's investment amounts are not maintained within a certain period of time;
- the Fund makes a distribution that results in having less than 100 percent of its investment authority;
- the Fund is found to invest more than either \$5 million, or 20 percent of its investment authority, in the same targeted small business, including affiliates; or
- the Fund makes an investment in a targeted small business that has some ownership or is an investor in the fund.

The fund has 90 days from notice by Commerce to correct any violation and avoid revocation of the certificate.

Qualifying Funds. Beginning November 1, 2019, Commerce must accept applications for approval as a Fund. The application must include:

- the total investment authority sought by the applicant under the business plan;
- a copy of the applicant's license as a RBIC or as a SBIC;
- evidence that the applicant has invested at least \$150 million in nonpublic companies located in areas that would be qualified areas if in Washington;
- an estimate of the number of jobs that will be created or retained in this state as a result of the Fund's 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 investments for the ten years following the date of the application;

- a signed affidavit from each investor stating the amount of contributions each taxpayer commits to make and against which of the two tax types the investor plans to apply the credit; and
- a nonrefundable application fee of \$5,000, to be deposited an appropriated account under Commerce.

When approved, Commerce must provide written approval to the applicant specifying the amount of the applicant's investment authority.

Within a certain amount of time after approval from Commerce, the Fund must collect the contributions from each investor; and collect one or more investments of cash that equal the Fund's total investment authority with documentation to prove amounts have been collected. If the Fund fails to comply, approval lapses. Commerce must first award lapsed investment authority pro rata to each Fund that was provided less than the requested investment authority, followed by new applicants.

Denial of an Application. An application will be denied if:

- the application is incomplete;
- the fee had not been paid;
- they do not hold an RBIC or SBIC license;
- the revenue impact assessment submitted does not demonstrate positive economic impact on aggregate state and local government revenue over a ten-year period that exceeds the cumulative amount of tax credits that would be issued to the applicant's investors;
- credit-eligible capital contribution do not equal at least 60 percent of the total amount of investment authority sought under the applicant's business plan; or
- Commerce has already approved the maximum amount of investment authority and credit-eligible capital contributions allowed.

If denied, the applicant may provide additional information within 15 days of the notice of denial for reconsideration and determination. Commerce must then review and reconsider those within 30 days.

Fund Operations. Each Fund must submit a report that includes certain information on the investments made and jobs created and retained by those investments to Commerce on or before each anniversary of the closing date until the Fund exits the program.

On or after the sixth anniversary of the closing date, a Fund may apply to Commerce to exit the program, bearing approval from Commerce. Before approving exit from the program, Commerce must evaluate the number of jobs created or retained by the Fund and determine whether repayment to the state for tax credits is warranted as a result of the number of jobs created and retained is insufficient.

Before making a growth investment, the Fund may request from Commerce a written opinion as to whether the business is planning to invest in is a targeted small business

Reporting and Expiration of Program. By November 1, 2019, and annually thereafter, Commerce must submit a report to the economic development committees of the Legislature

that includes names of applicants, criteria used to select the applicants, and a summary of each Fund.

This program will expire on July 1, 2025.

Extension of Reduced B&O Tax Rate on Certain Timber Products. The reduced B&O tax rate on certain activities related to the timber industry is extended to July 1, 2056.

**EFFECT OF CHANGES MADE BY FINANCIAL INSTITUTIONS, ECONOMIC DEVELOPMENT & TRADE COMMITTEE (First Substitute):**

- Changes the approval date for application by Commerce from November 1, 2019 to January 1, 2020.
- Changes the reporting date by Commerce to the appropriate economic development committees of the legislature from November 1, 2019 to January 1, 2020.

**Appropriation:** None.

**Fiscal Note:** Requested on January 19, 2019.

**Creates Committee/Commission/Task Force that includes Legislative members:** No.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Staff Summary of Public Testimony on Original Bill:** *The committee recommended a different version of the bill than what was heard.* PRO: This is about economic development in rural, distressed areas. All tax preferences should be written this way. This is a targeted approach, and has strict accountability. If this legislation does not create the jobs and economic development we want, there are penalties and provisions for the credits to be paid back. Part of the challenge of economic development in rural areas is access to capital. This fills a gap in what a local bank or credit union can provide. When the tax credit is taken, the entity must certify they are creating a certain amount of revenue and jobs or else they must pay back the amount taken as credits. Opportunity zone language takes advantage of equity available now. This creates a private investment fund to support and expand businesses into rural areas. Banks have money to lend but some customers need to come up with more capital than what a bank can provide. This bill helps reduce the bank's risk. The legislation's focus on under-served areas and opportunity zones, the small and medium-sized businesses that already exist, and the accountability provisions on job-creation and tax revenue would provide benefit to Washington's economy.

OTHER: The tax relief provided to the timber industry is appreciated. There is huge disparity in incomes and economic development between rural areas and the I-5 corridor. Tax preferences, credits, exemptions, and new programs are a patchwork approach. There are structural challenges with our current tax system that need to be looked at.

**Persons Testifying:** PRO: Senator Guy Palumbo, Prime Sponsor; Mike Ennis, Association of Washington Business; Dru Garson, Greater Grays Harbor Incorporated; Steve Gano, Advantage Capital; Andrew Mesojednik, Bank of the Pacific; Jennifer Ziegler, Washington

Economic Development Association.

OTHER: Patrick Connor, NFIB.

**Persons Signed In To Testify But Not Testifying:** No one.