The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Commerce Committee

BILL: CS/SB 850

INTRODUCER: Commerce Committee and Senator Fasano

SUBJECT: New Markets tax credit program

DATE: March 18, 2008 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pugh	Cooper	CM	**Fav/CS**
2.			CA	
3.			FT	
4.			TA	
5.				
6.				

I. Summary:

CS/SB 850 creates state tax credits for corporate income tax, under s. 220.11, F.S., and premium insurance tax, under s. 624.509, F.S., for qualified investments in Florida low-income communities. The bill's purpose is to make Florida more attractive to national investors participating in the federal New Markets Tax Credits program by establishing a state "piggy-back" on tax credits offered by the federal program.

Potentially, investors in Florida New Markets projects can recapture up to 50 percent of their investment as a state tax credit, in addition to the 39-percent income tax credit allowed under the federal program.

The maximum amount of tax credits available for allocation is $15 million a year for 7 years, for a total of $105 million. The tax credits may be carried forward to future taxable years, until December 31, 2029. The credits are not refundable or transferable, except when a qualified equity investment with unused credits is transferred to a new owner.

The state program is envisioned to work like this:

- One or more qualified community development entities (CDE's) will attract private investors, typically large banks or insurers, to invest in proposed business development projects in low-income communities.
- The CDE's then will apply for an <u>allocation</u> of the tax credits from the state Department of Revenue (DOR), on a first-come, first-served basis, beginning July 1, 2008.
- DOR will allocate the credits to the CDE's, but distribute them to private investors who are certified by the Governor's Office of Tourism, Trade, and Economic Development

(OTTED) as having made "qualified equity investments" in qualified projects through a CDE.

- Up to $15 million in new tax credits may be claimed by the investors in any year, but since the credits can be carried over until 2029, it is possible that more than $15 million in tax credits could be claimed by investors in any tax year.

CS/SB 850 creates Part XII, in ch. 288 of the Florida Statutes, and amends ss. 213.053, 220.02, and 220.13, F.S.

II. Present Situation:

Florida's use of tax credits as venture capital incentives

The State of Florida offers direct tax credits for premium insurance tax through the Certified Capital Company Act (CAPCO), pursuant to Part XI of ch. 288, F.S.

Enacted in 1998 by the Florida Legislature, CAPCO encourages private investment in venture capital by providing direct tax credits for investment in qualified businesses. The stated purpose of this act is to stimulate a substantial increase in venture capital investments in Florida by providing an incentive for insurance companies to invest in state-certified capital companies (CAPCOs) which, in turn, will invest in new or expanding businesses.[1] Eligible insurance companies are granted insurance premium tax credits in amounts equal to investments in CAPCOs. The increase in investment capital is intended to contribute to employment growth, create high-paying jobs, and expand or diversify Florida's economy.

According to information in OTTED's most recent report on the CAPCO program, there were 47 qualified businesses in which the CAPCOs had invested as of December 31, 2004.[2] The insurance industry has invested $150 million in three state-certified CAPCOs, and insurance companies may claim insurance premium tax credits totaling $15 million each year for 10 years.

Examples of industries represented by the qualified businesses are: electronic imaging, medical technology, boat manufacturing, credit card payment processing, vehicle fleet management systems, an internet portal for fishermen, and a cookie manufacturer. The most recent investments include businesses predominantly in the child daycare, landscaping, and restaurant industries. The total number of full-time jobs in qualified businesses at the time of the initial investments in the 47 companies was 1,218. The total number of full-time jobs in all qualified businesses as of December 31, 2004, was 1,009.

While as many as nine states have created CAPCOs, this type of program is increasingly viewed by researchers as the more "problematic" of the Venture Capital Funds (VCF) programs, in terms of:

> "…its high cost, poor design and target-inefficiency. Unlike any other VCF program, the CAPCO program provides a 100% premium tax credit

[1] Section 288.99(2), F.S.

[2] Section 288.99(12), F.S., requires OTTED to report annually on the performance of the CAPCO program. The information was compiled from the latest annual report issued in 2004. Executive Office of the Governor, Office of Tourism, Trade & Economic Development, *Certified Capital Company Act Annual Report on Performance*, June 2005.

to insurance company investors. In effect, the government underwrites the entire investment risk."[3]

The federal New Market Tax Credit Program

Created in 2000, the New Markets Tax Credit Program[4] permits taxpayers to receive a credit against federal income taxes for making qualified equity investments in designated Community Development Entities (CDE's). Substantially all of the qualified equity investment must in turn be used by the CDE to provide loans or capitalization projects in low-income communities. CDE's are certified by the U.S. Treasury Department and receive an allocation of federal income tax credits. The CDE's use these allocated tax credits to attract investors, and award the credits to their investors after receiving the investments.

The credit provided to an investor totals 39 percent of the cost of the investment and is claimed over a 7-year credit allowance period. In each of the first 3 years, the investor receives a credit equal to 5 percent of the total amount paid for the stock or capital interest at the time of purchase. For the final 4 years, the value of the credit is 6 percent annually. Investors may not redeem their investments in CDE's prior to the conclusion of the 7-year period.[5]

An organization wishing to receive awards under the New Markets Tax Credit Program must be certified as a CDE by the U.S. Department of Treasury. To qualify as a CDE, an organization must:

- Be a domestic corporation or partnership at the time of the certification application;
- Demonstrate a primary mission of serving, or providing investment capital for, low-income communities or low-income persons; and
- Maintain accountability to residents of low-income communities through representation on a governing board of, or advisory board to, the entity.[6]

For the purposes of the federal law, "low-income communities" are census tracts:

- With at least a 20-percent poverty rate; or
- Where the median family income does not exceed 80 percent of the area median family income; or
- Which have a population of less than 2,000, are contained within a federally designated Empowerment Zone, and are contiguous to at least one other low-income community; or
- Where the median family income does not exceed 85 percent of the area median family income, provided the census tract is located in a high-migration rural county.

Responsible for monitoring the program are the IRS and the U.S. Treasury Department's Community Development Financial Institutions Fund.

[3] Statement of Professor Daniel Sandler, University of Western Ontario, London; senior research fellow of the Taxation Law and Policy Research Institute, Melbourne; associated with Minden Gross Grafstein & Greenstein LLP, Toronto. See Daniel Sandler, *Venture Capital and Tax Incentives: A Comparative Study of Canada and the United States* (Toronto: Canadian Tax Foundation, 2004).
[4] 26 CFR Parts 1 and 602, and Sec. 45D, Internal Revenue Code.
[5] Information contained in this paragraph can be found at http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5.
[6] Available online at http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5 .

Since the inception of the New Markets program, Congress has approved $19.5 billion in federal tax credit allocation authority, of which at least $16 billion has been claimed by CDE's for their investors.[7] In the first four rounds of the federal tax credit allocations, CDE's whose service areas include Florida have received federal income tax credit allocations of at least $1.83 billion.[8] The amount of federal tax credits redeemed by investors against their federal income tax liabilities is not readily determinable.

A 2007 General Accounting Office (GAO) report indicated that Florida ranked 25th in total investment dollars during fiscal years 2003-2005 related to the New Markets Tax Credit program. Through 2005, Florida had attracted $38.26 million in total loans and investments related to the New Markets program, financing eight projects, according to the GAO report.[9] More recent information about the level of investment by CDE's in Florida appears to be unavailable. However, 15 different CDE's whose service areas include Florida received $1.57 billion in federal New Markets tax credits in 2006 and 2007;[10] how they have invested the money is not readily available online.

As of 2007, there were 63 CDE's with service areas in Florida,[11] trailing only New York (121), California (116), Texas (66), Pennsylvania (59), and Illinois (58). Nationally, there are 2,223 federally certified CDE's.

A GIS map prepared using data maintained by the U.S. Treasury's Community Development Financial Institutions Fund indicates areas within nearly two dozen Florida counties that are New Market Tax Credit Qualified Tracts, because they meet the low-income and other federal requirements.

The federal New Markets Tax Credit Program is set to expire at the end of 2008, but legislation has been filed to extend it.[12]

III. Effect of Proposed Changes:

General Overview

CS/SB 850 creates a "new markets development program" in Part XII of ch. 288, F.S. The program will provide $105 million in tax credits for corporate income tax, under s. 220.11, F.S., and premium insurance tax, under s. 624.509, F.S., in exchange for qualified investments in low-income Florida communities.

Under the program, DOR will allocate tax credits to federally certified CDE's that also have been certified by OTTED. The CDE's will use this allocation to attract private investors in Florida's low-income communities. The investors' tax credits will be based on their individual

[7] Available online at http://www.cdfifund.gov/what_we_do/programs.

[8] Information available at http://www.rapoza.org.

[9] United States Government Accounting Office Report GAO-07-297, *New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities but Opportunities Exist to Better Monitor Compliance*, January, 2007.

[10] U.S. Department of the Treasury's Community Development Financial Investment Fund web page, under "Program Materials Archives." Retrievable at http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5.

[11] Available online at http://www.cdfifund.gov/awardees.

[12] S. 1239 and HR 2075 have been introduced. They would reauthorize the New Markets Tax Credit program with $3.5 billion in allocation authority made available per year from 2009-2013. Track their progress at http://thomas.loc.gov/.

proportionate shares of the total investment in a project. The investors may use their tax credits in increments over 6 taxable years to reduce their corporate or premium insurance tax liabilities.

Section 1 creates Part XII of ch. 288, F.S., which is designated the "New Markets Tax Credit." Within Part XII is one section of law, s. 288.991, F.S., that delineates the tax credit program.

Section 288.991(1), F.S., expresses the program's purpose and subsection (2) defines a number of terms unique to this proposal. The definitions primarily mirror those used in the federal law.

Among the key definitions is "qualified equity investment," which is defined to mean any equity investment or long-term debt security that:

- Is acquired on or after July 1, 2008, solely in exchange for cash at the time of its original issuance;
- Has at least 85 percent of its cash purchase price invested by a CDE in qualified low-income community investments; and
- Is certified by the Office of Tourism, Trade and Economic Development (OTTED).

A "low-income community" means any population tract within the state where:

- The federal individual poverty rate is at least 20 percent; or
- In the case of a tract that is located <u>within a metropolitan area</u>, the median family income does not exceed 80 percent of the greater of the statewide media family income or the metropolitan area median income; or
- If not located in a metropolitan area, the median family income does not exceed 80 percent of the statewide median family income.

<u>Beginning the Investment Process</u>
The remaining subsections detail the certification process, the investment process, the earning and claiming of tax credits, and auditing and reporting requirements.

To be eligible for certification by OTTED, a qualified CDE first must be certified pursuant to IRS code, have entered into an allocation agreement with the Treasury Department's Community Development Financial Institutions Fund for federal New Markets tax credits, and must have Florida included within its federal New Markets service area.

The CDE also must file an application with OTTED that includes its federal documentation, certain information about the project in which potential investors will invest their funds, a statement of the CDE's plans on how it will develop relationships with the community in which the project will be located, and a nonrefundable $1,000 application fee. OTTED must either certify or deny the application within 30 days. OTTED's certification means the investors are eligible for the state tax credits.

If OTTED denies a CDE's application, then the CDE has 15 days to provide additional information in response to OTTED's concerns.

CDE's will place their investments in "qualified active low-income community businesses" as defined in federal law, but excludes any trade or business that:

- Derives 15 percent or more of their annual revenue from the rental or sale of real estate;
- Engages predominantly in the development or holding of intangibles for sale or licenses;
- Operates a golf course, country club, massage parlor, hot-tub facility, suntan facility, race track or other facility used for gambling, or a store whose principle business is the sale of alcoholic beverages for consumption off premises; or
- Is principally involved in farming, if the sum of the aggregate unadjusted bases or the fair market value of the assets owned by the business, and the aggregate value of its leased assets exceeds $500,000.

Additionally, the businesses that are to receive the equity investments must be among the types of industries on a comprehensive list developed by OTTED and Enterprise Florida, Inc. (EFI), that "lead to strong positive impacts on or benefits to the state and regional economies." Copies of the list (and any future modifications) must be submitted to the President of the Senate and the Speaker of the House of Representatives.

State Tax Credits

Pursuant to the process in CS/SB 850:

- DOR will allocate, or set aside in the CDE's name, an amount of tax credits based on the anticipated investments, on a first-come, first-served basis. All of the $105 million in credits could be allocated to CDE's in the first year, but supporters of the bill say that is unlikely.
- DOR will distribute the tax credits to the private investors who receive a certification letter from OTTED indicating the amount of investments and that the applicable CDE attests to their validity. The credits will be distributed to the certified investors, based proportionately on their level of investment.
- Only $15 million in tax credits can be claimed each year, exclusive of tax credits from previous years that have carried forward.
- CS/SB 850 allows state New Markets tax credits to be taken by CDE investors annually only after the investment has been made and held for 1 full year. The credit is 8.33 percent of the adjusted purchase price of the equity investment for 6 years, beginning 1 year after the original date of the investment. Over 6 years, this credit totals 50 percent of the investment. Any amount of the tax credit may be carried forward to future taxable years, but all unused credits expire on December 31, 2029.

CS/SB 850 prohibits the transfer or sale of tax credits. However, CS.SB 850 implies transferability because it does allow a tax credit "pass-through" to partners, members, or shareholders, depending on the type of entity that first obtained the tax credits. Also, if a qualified investment is transferred to a new owner, any unused credits travel with it.

The federal program provides credits totaling 39 percent of the investment over a 7-year period. So, a company with a qualified investment for both the federal and state programs would receive 89 percent of the purchase price of its investment in tax credits, in addition to any profits generated from the investments. Under this scenario, a business would qualify for credits as follows:

Tax Year	State Program	Federal Program
1	0%	5%
2	8.33%	5%
3	8.33%	5%
4	8.33%	6%
5	8.33%	6%
6	8.33%	6%
7	8.33%	6%

OTTED will direct DOR to recapture tax credits available to an investor if:

- For any reason the federal government recaptures a related tax credit;
- The CDE becomes disqualified from the state program;
- The CDE redeems or makes any principal repayment related to the investment prior to its seventh anniversary;
- The CDE fails to make qualified low-income community investments in qualified active low-income businesses;
- The requirement to maintain at least 85 percent of the investment in low-income community investments in Florida is not met;
- The CDE fails to provide OTTED or DOR any of the required information or documents; or
- OTTED determines from an audit or other examination that a taxpayer received tax credits for which it was not entitled.

OTTED may disqualify a CDE from receiving additional state New Markets tax credits if more than 50 percent of its qualified equity investments, during the first 3 years of operation, become insolvent, are reorganized or liquidated in bankruptcy or receivership, or are dissolved. In such instances, OTTED also shall recapture 50 percent of all credits awarded to the CDE.

OTTED must provide notice to a CDE and to DOR before recapturing the CDE's credits, and the CDE has 90 days to correct any deficiencies.

CS/SB 850 requires each CDE that makes qualified equity investments in Florida to annually provide OTTED with the following information:

- Its annual, audit financial statements;
- A list of the counties where the investments have been put to work, the dollars invested; and the number of jobs created and retained;
- A statement describing the relationships the CDE has established with community-based organizations, local community development offices and organizations, economic development organizations, and a summary of the outcomes resulting from those relationships; and
- Any other information and documentation as requested by OTTED.

OTTED must prepare an annual report of all the CDE's using the above information, along with the value of tax credits claimed for the latest year available. The report shall be submitted to the

Governor, the President of the Senate, and the Speaker of the House of Representatives each July 1, beginning in 2010. This report also may be posted on OTTED's website.

CS/SB 850 gives DOR rulemaking and auditing authority to administer this tax credit program.

Section 288.991, F.S., expires Dec. 31, 2029.

Section 2 amends s. 220.02, F.S., to add the corporate income tax credits awarded under this program at the end of the list of similar credits.

Section 3 amends s. 220.13, F.S., to address the issue of claiming corporate income credits on federal income tax returns.

Section 4 amends s. 213.053, F.S., to allow DOR to disclose to OTTED and specified employees certain confidential tax information related to entities claiming New Markets tax credits.

Section 5 provides an effective date of July 1, 2008, and specifies that this act applies to tax years ending after December 31, 2008.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Indeterminate. The legislation may facilitate the development of new or expanded businesses, and new jobs, to some of Florida's poorest communities.

C. Government Sector Impact:

On March 14, 2008, the Revenue Estimating Conference estimated a $15 million negative impact on recurring state general funds, beginning in FY 09-10.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Commerce Committee on March 18, 2008:

- Corrects a scrivener's error, changing the number of credit allowance dates from five to six;
- Removed language relating to the irrevocable election of tax credits, which DOR determined was unnecessary;
- Added a provision allowing OTTED and EFI to develop a list of industries eligible for the New Markets program;
- Allows OTTED to disqualify and recoup tax credits when a CDE exhibits a pattern of failed investments in Florida, where 50 percent of investments fail over a 3-year period;
- Removes a provision allowing an incomplete or incorrect application to be considered submitted on the original submission date if corrections are made within 15 days;
- Makes any CDE that is disqualified from the federal program ineligible for the Florida program;
- Requires CDE's to submit any other information as prescribed by OTTED and verification of continuation with the federal program; and
- Deletes the requirement for OTTED to create forms and applications by rule.

B. Amendments:

None.