

The Florida Senate
PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

Prepared By: Community Affairs Committee

BILL: CS/CS/SB 2280

INTRODUCER: Community Affairs Committee; Commerce Committee; Senators Bennett and Lynn

SUBJECT: Premium and Corporate Income Tax Credits

DATE: April 18, 2007

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Pugh</u>	<u>Cooper</u>	<u>CM</u>	Fav/CS
2.	<u>Herrin</u>	<u>Yeatman</u>	<u>CA</u>	Fav/CS
3.	_____	_____	<u>FT</u>	_____
4.	_____	_____	<u>GA</u>	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The committee substitute for committee substitute (CS) 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’s low-income communities. The cap on tax credits claimed is \$15 million a year.

The CS’s intent 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. The new state tax credit is modeled after the federal program, but departs from the federal law in certain respects.

As envisioned by the drafters of the CS, one or more qualified community development entities (CDEs) will attract private investors, typically large banks or insurers, to invest in proposed business development projects in low-income communities. The CDEs then will apply for an allocation of tax credits from the state Department of Revenue (DOR or department). Next, DOR will allocate the credits, up to \$15 million annually, to the CDEs on a first-come, first-served basis. DOR will continue to hold the credits and distribute them to the private investors who are certified by the Governor’s Office of Tourism, Trade, and Economic Development (OTTED) as having made their investments in qualified projects through a CDE.

A tax credit provided under this CS is valued at 8.33 percent per year for 6 years after the original date of the investment. Over 6 years, this credit totals 50 percent of the investment. The tax credit is repealed on December 31, 2028.

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 cost of its investment in tax credits. This would be in addition to any profits generated from its investments.

The CS creates Part XII, in ch. 288 of the Florida Statutes.

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.

To date, the insurance industry has invested \$150 million in three state-certified CAPCOs. The insurance companies may claim insurance premium tax credits totaling \$15 million each year for 10 years.

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

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.

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).

Federal New Market Tax Credit Program

Created in 2000, the New Markets Tax Credit Program⁴ permits taxpayers to receive a credit against federal income taxes for making qualified equity investments in designated Community Development Entities (CDEs). Substantially all of the qualified equity investment must in turn be used by the CDE to provide investments in low-income communities. CDEs are certified by the U.S. Treasury Department and receive an allocation of federal income tax credits. The CDEs use these allocated tax credits to attract investors, and award the credits to their investors after receiving the investments.

The credit provided to the 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 CDEs 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 Treasury’s Community Development Financial Institutions Fund.

Since the program’s inception, Congress has approved \$16 billion in federal tax credit allocation authority, of which \$12.1 billion has been claimed by CDEs for their investors.⁷ In the first four rounds of federal tax credit allocations, CDEs whose service areas include Florida have received

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.

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

federal income tax credit allocations of \$1.83 billion.⁸ The amount of federal tax credits redeemed by investors against their federal income tax liabilities is not readily determinable.

A recent federal report indicated that Florida ranked 25th in total investment dollars during fiscal years 2003-2005 related to the New Markets Tax Credit program. CDEs in this state attracted only 1.23 percent of total loans and investments related to the program, financing only 8 total projects.⁹

As of May 1, 2006, there are 56 CDEs in Florida,¹⁰ trailing only New York (121), California (116), Texas (66), Pennsylvania (59), and Illinois (58). Nationally, there are 2,223 federally certified CDEs.

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 federal low-income and other requirements.

The federal New Markets Tax Credit Program is set to expire at the end of 2008.¹¹

III. Effect of Proposed Changes:

The CS creates a "new markets development program" in Part XII of ch. 288, F.S. The program will provide \$15 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.

DOR will allocate tax credits to federally certified CDEs, which in turn will use this allocation to attract private investors in Florida's low-income communities. The investors' tax credits will be based on their individual 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 s. 288.991, F.S., referring to part XII of ch. 288, F.S., as the "New Markets Tax Credit Act." It also creates s. 288.992, F.S., which governs the new markets tax credits. It defines a number of terms unique to this proposal, and includes substantive provisions within those definitions. The definitions primarily mirror those used in the federal law.

⁸ Information available at <http://www.rapoza.org>.

⁹ United States Government Accounting Office (GAO) Report 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 Available online at <http://www.cdfifund.gov/docs/certification/CDEstate.pdf>.

¹¹ GAO Report 07-297, pages 14-15.

Qualified Investments

A “qualified equity investment” means any equity investment or long-term debt security by a qualified CDE that:

- Is acquired on or after July 1, 2007;
- Has at least 85 percent of its cash purchase price invested in qualified low-income community investments; and
- Is designated by the CDE as a qualified equity investment, regardless whether the investment was designated under the federal New Markets Tax Credit Program.

In addition, a qualified equity investment may mean an equity investment or long-term debt security that is currently a qualified equity investment.

The qualified equity investment does not have to be approved under the federal program. As such, the CS appears to be missing program criteria and oversight for those investments not approved by the federal program.

The definition for a “qualified equity investment” in this CS expands the federal definition allowed under Sec. 45D of the Internal Revenue Code. It allows a CDE to designate a qualified investment regardless of whether it is approved under the federal program; and it allows for long-term debt security to be a qualified investment.

“Long-term debt security” means any debt instrument issued by a CDE, “at par value or a premium, having an original maturity date of at least 7 years following the date of its issuance, with no acceleration of repayment, amortization, or prepayment features before its original maturity date, and having no distribution, payment, or interest features related to the profitability of the qualified community development entity or performance of the qualified community development entity’s investment portfolio.” A “qualified active low-income community business” is defined as having the same meaning as what is provided in federal law. It also includes language different from federal law that states the business must not derive 15 percent or more of its annual revenue from the rental or sale of real estate.

State Tax Credits

The CS allows a tax credit to be taken annually only after the investment has been made and held for a full year. The credit provided under this CS is 8.33 percent per year for six years after the originally date of the investment. Over six years this credit totals 50 percent of the investment. Any amount of the tax credit may be carried forward infinitely, for future taxable years. The tax credits are allocated on a first-come, first-serve basis.

The federal program provides credits totaling 39 percent of the investment over a seven year period. A company with a qualified investment for both the federal and state program would receive 89 percent of the purchase price of the investment in tax credits.

A business would qualify for credits as follows:

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%

The issuer¹² certifies an investment to the Department of Revenue (department). The CDE is required to provide the department the anticipated dollar amount of an investment in the state during the first 12-month period following the initial credit allowance date. The department is required to adjust future credits if the actual amount of the investment is different from the estimated amount.

The CS does not allow the transfer or sale of tax credits, but does allow a tax credit to travel with the purchase of an investment to a new owner.

The maximum amount of tax credits allowed in any year shall not exceed \$15 million.

DOR is directed to recapture tax credits available to an investor if:

- For any reason the federal government recaptures a related tax credit;
- The CDE redeems any principal repayment related to the investment prior to its seventh anniversary; or
- The requirement to maintain at least 85 percent of the investment in low-income community investments in Florida is not met.

The CS requires each CDE that makes qualified equity investments in Florida to annually report to OTTED certain information on qualified equity investments. OTTED must file an annual report on all qualified low-income community investments with the Governor and the Legislature beginning July 1, 2009, and may post the report on OTTED’s website.

The CS gives DOR and OTTED rulemaking and auditing authority to administer this tax credit program.

Applicants that submit fraudulent information to DOR or OTTED are liable for reimbursement of reasonable costs and fees associated with the review, processing, investigation, and prosecution of the fraudulent claim. Persons who fraudulently obtain a tax credit under this section are liable for reimbursement of the credit amount claimed, a penalty in an amount double to that of the tax credit claimed, and other fees and penalties associated with the state’s investigation and prosecution of the matter.

¹² The term “issuer” is not defined; but it appears it indicates the CDE.

Section 288.992, F.S., expires on December 31, 2028.

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 for purposes of applying such 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 authorized OTTED employees, for purposes of their official duties, to obtain information from the Department of Revenue relating to tax credits taken by a taxpayer under s. 288.991, F.S. OTTED is subject to the same confidentiality requirements with respect to this tax information as DOR.

Section 5 provides the CS shall take effect July 1, 2007, and apply to tax years ending after December 31, 2007.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

There would be no revenue loss to the state until FY 2008-2009, the first year the credits could be claimed against corporate income and insurance premium tax liabilities. The maximum amount of tax credits applied against tax liabilities is \$15 million a year. DOR estimates that the actual impact will start at perhaps \$2 million the second year and basically double in subsequent years until \$15 million is reached in year 7 of the program.

As a counterpoint, the CS's provisions may spur economic development in low-income communities, and generate sales and use tax and other state tax revenues.

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:

Indeterminate.

VI. Technical Deficiencies:

The word "expires" on pg. 17, line 19, should be changed to "is repealed."

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.

This Senate Professional Staff Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
