

**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: Commerce Committee

BILL: CS/SB 2280

INTRODUCER: Commerce Committee and Senator Bennett

SUBJECT: Premium and Corporate Income Tax Credits

DATE: March 28, 2007                      REVISED: \_\_\_\_\_

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

**I. Summary:**

CS/SB 2280 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 cap on tax credits claimed is \$15 million a year.

CS/SB 2280’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 CS/SB 2280, 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). 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 CS/SB 2280 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. Any amount of the tax credit may be carried forward to future taxable years, until 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.

CS/SB 2280 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.<sup>1</sup> 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.<sup>2</sup> 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

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<sup>1</sup> Section 288.99(2), F.S.

<sup>2</sup> 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.”<sup>3</sup>

#### The federal New Market Tax Credit Program

Created in 2000, the New Markets Tax Credit Program<sup>4</sup> 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.<sup>5</sup>

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.<sup>6</sup>

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.

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<sup>3</sup> 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).

<sup>4</sup> 26 CFR Parts 1 and 602, and Sec. 45D, Internal Revenue Code.

<sup>5</sup> Information contained in this paragraph can be found at [http://www.cdifund.gov/what\\_we\\_do/programs\\_id.asp?programID=5](http://www.cdifund.gov/what_we_do/programs_id.asp?programID=5).

<sup>6</sup> Available online at [http://www.cdifund.gov/what\\_we\\_do/programs\\_id.asp?programID=5](http://www.cdifund.gov/what_we_do/programs_id.asp?programID=5).

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.<sup>7</sup> In the first four rounds of federal tax credit allocations, CDEs whose service areas include Florida have received federal income tax credit allocations of \$1.83 billion.<sup>8</sup> 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 25<sup>th</sup> 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.<sup>9</sup>

As of May 1, 2006, there are 56 CDEs in Florida,<sup>10</sup> 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.<sup>11</sup>

### III. Effect of Proposed Changes:

CS/SB 2280 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.

As the legislation is drafted, 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., the "New Markets Tax Credit Act."

**Section 2** creates s. 288.992, F.S., which governs the new markets tax credits.

CS/SB 2280 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. Where the bill differs from federal law, and where it attempts to overlay the provisions

<sup>7</sup> Available online at [http://www.cdfifund.gov/what we do/programs](http://www.cdfifund.gov/what_we_do/programs).

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

<sup>9</sup> 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.

<sup>10</sup> Available online at <http://www.cdfifund.gov/docs/certification/CDEstate.pdf>.

<sup>11</sup> GAO Report 07-297, pages 14-15.

approved in federal law with Florida law, may create problems with implementation and monitoring. [See, “VII. RELATED ISSUES” below.]

#### Investment Processes

Under CS/SB 2280, a CDE identifies a “qualified equity investment” to mean any equity investment or long-term debt security (not part of the federal program) 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 of whether the investment was designated under the federal New Markets Tax Credit Program, as amended. All applicable provisions of the federal tax code remain in full force.

The definition for a “qualified equity investment” in CS/SB 2280 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. A “long-term debt security” means any debt instrument issued “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.”

CDEs place their investments in “qualified active low-income community businesses” as defined in federal law, but with the additional provision in CS/SB 2280 that these types of businesses must not derive 15 percent or more of their annual revenue from the rental or sale of real estate.

#### State Tax Credits

The precise structure by which the state’s new markets tax credits will be awarded remains unclear in CS/SB 2280. However, as envisioned by the drafters of CS/SB 2280:

- One or more CDEs will identify potential business development projects in low-income communities, as defined by federal law, within Florida, and attract capital from private investors interested in participating.
- The CDEs will file an application with either DOR or OTTED that contains certain information about the business project and the investments, including their anticipated dollar amount, accompanied by audited financial statements and notarized affidavits.
- DOR will allocate, or set aside in the CDE’s name, an amount of tax credits based on the anticipated investments. Up to \$15 million in tax credits will be available annually to the CDEs on a first-come, first-served basis.
- 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.

- The investors must irrevocably inform DOR at the time of claiming the credits whether they want to apply them against their corporate income tax liability, their premium tax liability, or a combination of both.
- DOR is required to adjust future credits if the actual amount of the investment is different from the estimated amount. The legislation tries to create a process by which DOR can adjust the allocations in future years to account for differences between the investments estimated and the actual amount invested.

CS/SB 2280 allows a state tax credit 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 per year 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, 2028.

CS/SB 2280 does not allow the transfer or sale of tax credits. However, it implies transferability because it does allow a tax credit to be reallocated to partners, members, or shareholders, depending on the type of entity that first obtained the tax credits.

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:

<b>Tax Year</b>	<b>State Program</b>	<b>Federal Program</b>
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 maximum amount of tax credits claimed against corporate income tax and premium insurance tax shall not exceed \$15 million each fiscal year.

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; and
- The requirement to maintain at least 85 percent of the investment in low-income community investments in Florida is not met.

CS/SB 2280 requires each CDE that makes qualified equity investments in Florida to annually report to the state information related to the county where the investments were made; the dollars invested; and the number of jobs assisted by the investments.

The legislation requires DOR to file an annual report to the Governor and the Legislature that includes the CDEs' reports plus the value of applicable tax credits claimed the previous calendar year and other information. This report also shall be posted on DOR's website.

CS/SB 2280 gives DOR broad 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.

Section 299.992, F.S., is repealed July 1, 2014, except that the tax credit carry forward remains valid for the period specified. All unused credits expire on December 31, 2028.

**Section 3** 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 4** amends s. 220.13, F.S., to address the issue of claiming corporate income credits on federal income tax returns.

**Section 5** provides an effective date of July 1, 2007, and specifies that this act applies 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, CS/SB 2280's provisions may spur economic development in low-income communities, and generate sales and use tax and other state tax revenues.

The Revenue Estimating Conference has not reviewed CS/SB 2280.

**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:**

DOR has not completed an analysis of CS/SB 2280 because of the various implementation questions that have been raised.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

Some of the wording in CS/SB 2280 is confusing, mainly as a result, it appears, of the drafters' attempt to copy a federal program within Florida's existing tax and agency governance structures.

Also confusing is the use of the word "department" without defining it to mean either DOR or OTTED. Thus, the actual responsibilities of these two agencies pursuant to this legislation are not readily determinable.

Although the committee substitute does address many of DOR's initial concerns with the original bill, the agency continues to express concerns about the actual mechanisms for implementing an accountable tax credit programs.

Legislative staff, DOR, and OTTED have been meeting with the legislation's drafters to craft amendments that further clarify the intent of CS/SB 2280, and to improve its implementation.



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## **VIII. Summary of Amendments:**

None.

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

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