Statement of Estimated State Revenue Impact

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Bill Number: H.B. 4778

Authors: J.E. Smith, Cobb-Hunter, Kerbkersman, and G.M. Smith

Committee Requesting Impact: House Ways & Means Committee

Bill Summary

A bill to amend the Code of Laws of South Carolina, 1976, by adding Chapter 8 to Title 38 so as to enact the "South Carolina New Market Jobs Act" to provide a credit against insurance premium taxes and possible other states taxes made in certain investments by community development entities, providing investment capital for a qualified active low income community small business located in this state, to model this state insurance premium tax credit on the federal new markets tax credit program providing federal income tax credits for such investments but limited to investments in this state, to adopt federal definitions as applicable for the credit but modified to reflect the particular South Carolina application of the credits, to provide a maximum initial individual investment, a maximum overall limit for all such investments eligible for the credit, and an annual maximum amount of credit that may be claimed, to provide that these credits apply over seven years and are nonrefundable and not saleable, to require fees for processing applications for such credits and for recapture of the credits if qualifications are not maintained, to provide for letter rulings by the Department of Revenue when federal regulations do not provide specific guidance, and to provide other limitations and restrictions and reporting requirements.

REVENUE IMPACT [1/]

This bill is not expected to affect General Fund insurance premium tax revenue in FY2014-15. This bill would reduce General Fund insurance premium tax revenue by an estimated $30,000,000 in FY2015-16, $30,000,000 in FY2016-17, $30,000,000 in FY2017-18, $30,000,000 in FY2018-19, $25,000,000 in FY2019-20, and $0 in FY2020-21.

Explanation

Currently, there is a federal new market tax credit available for taxpayers making investments in low income communities. This bill would allow a qualified taxpayer to apply a nonrefundable state new market tax credit, in addition to the federal new market tax credit, against a qualified investment. At present, state new market tax credit programs are operating in fourteen states with proposed legislation introduced to create a new market tax credit program in several additional states. This bill would add Chapter 8 to Title 38 to add the South Carolina New Market Jobs Act to allow a nonrefundable tax credit against state insurance premium tax liability.

The New Markets Tax Credit (NMTC) Program, authorized pursuant to IRS Code 45D, was enacted by Congress as part of the Community Renewal Tax Relief Act of 2000. The NMTC was extended by Congress in 2013 at $3.5 billion annually under the American Taxpayer Relief Act. The CDFI Fund has not received Congressional allocation authority for calendar year 2014 as of March 2014. This program allows individual and corporate taxpayers to receive a credit against federal income taxes for making qualified equity investments (QEI's) in qualified community development entities (CDE's). These investments are targeted to job creation and material improvement in low income communities, and include financing for small business, community facilities, such as daycare centers, and increasing homeownership opportunities. The NMTC uses private capital to spur community and economic revitalization in low-income urban, suburban, and rural areas. Since 2000, the NMTC has generated investment in low income communities across all 50 states, the District of Columbia and Puerto Rico. According to the U.S. Department of the Treasury, the NMTC has raised more than $31 billion in private capital.

Each federal fiscal year, the amount of annual tax credits is authorized by Congress. The Community Development Financial Institutions Fund (CDFI) under the Department of the Treasury reviews applications and awards allocation authority to qualified Community Development entities (CDE) through a competitive process. The CDE's can receive investments called Qualified Equity Investments (QEI) from investors up to the amount of the allocation authority that the CDE has from the CDFI Fund. CDE's use the QEI dollars received from investors to make a loan or equity investment in a project or business called a Qualified Active Low-Income Community Business (QALICB). The projects and financing must be consistent with the way the CDE described their business plan in their application. The financing proceeds can be used for a variety of purposes and is often used to construct or rejuvenate real estate projects. CDE's are required to offer financing that has terms that are nontraditional or more flexible than conventional financing. Borrowers benefit from below market interest rates and underwriting terms that they could not receive from conventional financing. Many CDE's will only fund transactions that would not have been done but for the NMTC, in other words, a project either could not qualify for any conventional financing, or could not qualify for enough financing to cover the entire cost of the project without the subsidy created by the NMTC. NMTC projects are selected by CDE's in part based on the community impact that will be achieved. Communities benefit from newly created construction and permanent jobs, improved access to goods and services, including both retail and human services, and new recreation and entertainment options. Increased foot traffic in previously underserved markets can encourage future development. The federal tax credit is based on the amount of the QEI that is made into the CDE. Investors receive 5% per year in the first three years and 6% per year in the final four years. The QEI can be made up of an equity investment from the tax credit investor plus "leverage loans" from banks, affiliates of the QALICB of other third parties such as cities, state agencies, or other funding sources.

Upon the effective date of this bill, the Department of Revenue shall certify $250,000,000 in qualified equity investments. A qualified community development entity is defined as an entity that has entered into an allocation agreement with the Community Development Financial Institution Fund of the United States Treasury Department. The CDE would make qualified equity investments, or loans, to any qualified active low-income community business. The CDE is required to use at least eight-five percent of the investment in low-income investments in low-income community businesses in the State by the first anniversary of the initial credit allowance date. A single qualified business may not receive more than $4,000,000 in qualified investments. On each credit allowance date, a qualified investor is entitled to a credit in an amount equal to the applicable percentage for the credit allowance date multiplied by the purchase price paid to the qualified community development entity for the qualified equity investment.

Table 1 summarizes the credit allocation of the qualified equity investment over the seven year investment timeline. In Table 1, a $250,000,000 qualified investment is allocated over the seven year investment period. The federal applicable percentage is set in Years 1 through 7 according to IRS Section 45D and the state applicable percentage in Years 1 through 7 has been set by this bill. The tax credit amounts are equal to the qualified equity investment multiplied by the applicable percentage in each year. The federal new market tax credit allows thirty-nine percent of the qualified investment to be returned to the qualified investor. The state new market tax credit would allow fifty-eight percent of the qualified investment to be returned to the qualified investor. Combined, the federal and state credits would allow for ninety-seven percent of the qualified investment to be returned to the qualified investor virtually eliminating any risk to the investor. The most an investor could lose is three percent of the total qualified investment.

Table 1. State Income Tax Credit for New Markets Tax Credit Program

Period	Federal Applicable Percentage	Qualified Equity Investment	Tax Credit Amount	State Applicable Percentage	Qualified Equity Investment	Tax Credit Amount
Year 1	5%	$250,000,000	$12,500,000	0%	$250,000,000	$0
Year 2	5%	$250,000,000	$12,500,000	12%	$250,000,000	$30,000,000
Year 3	5%	$250,000,000	$12,500,000	12%	$250,000,000	$30,000,000
Year 4	6%	$250,000,000	$15,000,000	12%	$250,000,000	$30,000,000
Year 5	6%	$250,000,000	$15,000,000	12%	$250,000,000	$30,000,000
Year 6	6%	$250,000,000	$15,000,000	10%	$250,000,000	$25,000,000
Year 7	6%	$250,000,000	$15,000,000	0%	$250,000,000	$0
Total	39%		$97,500,000	58%		$145,000,000

Additionally, the amount of the nonrefundable tax credit claimed may not exceed the amount of the entity's state insurance premium tax liability in a tax year. Any unused tax credits may be carried forward to subsequent tax years. The tax credits are not saleable on the open market. Failure to meet or maintain any requirements may allow the Department of Revenue to recapture any tax credits claimed on a tax return.

A qualified community development entity that wishes to have an equity investment designated as a qualified equity investment and be eligible for a new market tax credit must make an application to the Department of Revenue beginning August 1, 2014. The applicant must include a nonrefundable application fee of $5,000 payable to the Department of Revenue, and if applicable, a refundable performance deposit in the amount of one-half of one percent (0.005) of the amount of the equity investment designated as a qualified equity investment on the application. This amount is to be deposited in the New Market Performance Guarantee Account in the State Treasury that is separate and distinct from the General Fund and all other funds. The entity forfeits the deposit if:

- the qualified community development entity fails to issue the total amount of the qualified equity investments certified by the Department of Revenue and receives cash in the total amount certified.

- the qualified community development entity fails to make qualified low-income community investment in qualified active low-income community businesses equal to at least eighty-five percent of the purchase price of the qualified equity investment by the second credit allowance date.

Once the qualified community development entity is compliant with the provisions of the qualified equity investment, the entity may request a refund of the deposit made to the New Market Performance Guarantee Account no sooner than thirty days after having met all of the above requirements. A qualified equity investment ceases to be under certification after the seventh credit allowance date.

Based on a qualified equity investment of $250,000,000 authorized by the Department of Revenue pursuant to Section 38-8-50(F), and applying the appropriate applicable tax credit percentage as shown in Table 1, this bill is not expected to affect General Fund insurance premium tax revenue in FY2014-15. This bill would reduce General Fund insurance premium tax revenue by an estimated $30,000,000 in FY2015-16, further reduce by an estimated $30,000,000 in FY2016-17, further reduce by an estimated $30,000,000 in FY2017-18, further reduce by an estimated $30,000,000 in FY2018-19, further reduce by an estimated $25,000,000 in FY2019-20, and is not expected to affect General Fund insurance premium tax revenue in FY2020-21. Over the seven year lifetime of the $250,000,000 qualified equity investment, all qualified investors would receive a total of $145,000,000, or fifty-eight percent of the original investment, in state nonrefundable tax credits. All qualified investors would also receive a total of $97,500,000, or thirty-nine percent of the original investment, in federal nonrefundable tax credits. Collectively, all qualified investors would receive a total of $242,500,000, or ninety-seven percent, in nonrefundable tax credits against a total of $250,000,000 of authorized qualified equity investments.

This act takes effect August 1, 2014, and applies with respect to returns and returns originally due on or after that date.

Frank A. Rainwater
Chief Economist

Analyst: Martin

[1/] This statement meets the requirement of Section 2-7-71 for a state revenue impact by the BEA, or Section 2-7-76 for a local revenue impact or Section 6-1-85(B) for an estimate of the shift in local property tax incidence by the Office of Economic Research.