



Ohio Legislative Service Commission

Bill Analysis

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S.B. 327

129th General Assembly
(As Introduced)

Sens. Beagle and Tavares, Seitz

BILL SUMMARY

- Increases the annual limit on the amount of Ohio New markets Tax Credits that may be awarded to taxpayers from \$10 million to \$50 million.
- Increases the annual per-taxpayer credit limit for an individual insurance company or financial institution from \$1 million to \$3.9 million.
- Prevents the credit from increasing the retaliatory tax paid by certain foreign insurance companies.
- Allows a six-month period for a credit recipient to cure noncompliance with the conditions of receiving a credit before being subject to recapture penalties.
- Prescribes an application process for certification of credit-eligible investments in which approval is based on the date an application is submitted.
- Specifies how soon a taxpayer's investment in a Community Development Entity must be converted by the entity into an investment in a low-income community business in order to qualify for the credit.
- Allows Community Development Entities to make credit-eligible investments in a business that derives 15% or more of its annual revenue from renting or selling real estate.

CONTENT AND OPERATION

New Markets Tax Credit

Current law authorizes a nonrefundable tax credit with a four-year carryforward against the insurance and financial institution franchise taxes for insurance companies

and financial institutions that purchase and hold securities issued by low-income community organizations to finance investments in qualified active low-income community businesses in Ohio, in accordance with the federal New Markets Tax Credit law.¹

Federal credit

Federal law provides a credit against the federal income tax, totaling 39% of the cost of the investment at original issue, for making qualified equity investments in investment vehicles known as Community Development Entities (CDEs). A CDE is a United States corporation or partnership with the primary mission of serving or providing investment capital for businesses in low-income communities, that maintains accountability to residents of low-income communities through representation by them on the CDE's governing board or an advisory board, and that is certified as a CDE by the Secretary of the Treasury.

A qualified equity investment is the purchase of capital stock or capital interest in a partnership. The credit provided to the investor is applied over a seven-year period. Substantially all of the taxpayer's investment must in turn be used by the CDE to make qualified investments in "low-income communities."² Federal regulations require CDEs to make the qualified investments within one year after receiving the taxpayer's investment.³

Ohio credit

The current Ohio New Markets Tax Credit totals 39% of the "adjusted purchase price" of qualified equity investments in CDEs that use substantially all of the proceeds to make investments in qualified active low-income community businesses. To obtain the Ohio credit, a person must have qualified for the federal credit by holding a qualified equity investment. Under the Federal program, a CDE can make qualified investments in any state. For purposes of the Ohio credit, the "adjusted purchase price" of qualified investments is the percentage of those investments that are made in businesses located in Ohio. A qualified equity investment is an equity investment in a qualified CDE. An investor eligible to receive tax credits for its investment in a qualified CDE must be an insurance company subject to the state's insurance company franchise taxes or a financial institution subject to the state's corporation franchise tax. To be a qualified equity investment, the equity investment must be acquired after

¹ 26 U.S.C. 45D; R.C. 5725.33, 5729.16, and 5733.58.

² 26 U.S.C. 45D (2012).

³ 26 C.F.R. 1.45D-1.

October 16, 2009, for cash, and at least 85% of the purchase price must be used by the issuer to make qualified low-income community investments. The investment may be transferred, so long as the transferee's holding would qualify if the transferee were the purchaser at the original issuance.

Credits must be applied over a seven-year period, beginning on the date a qualified equity investment is made and continuing for the next six anniversary dates. In the first two years no credit may be applied. An amount equal to 7% of the qualified CDE's qualified equity investment may be applied for the third year and 8% for each of the remaining four years, for a total credit of 39%.⁴

Credit limits

Under continuing law, the amount of the credit that an insurance company or financial institution holding a qualified equity investment may claim is equal to 39% of the adjusted purchase price of qualified low-income community investments. Under current law, the amount of qualified low-income community investments is the total amount of investments that are invested in qualified low-income community businesses, up to \$2,564,000 in a fiscal year, for a maximum credit of about \$1 million.⁵

The bill increases the maximum credit-eligible qualified low-income community investments to \$10 million per taxpayer, for a maximum allowable individual credit of \$3,900,000 (39% of \$10 million).⁶

Currently, the Director of Development is authorized to award a combined maximum of \$10 million in tax credits per fiscal year (disregarding any credit carry-forwards). The bill increases this maximum to \$50 million. The bill also clarifies that the combined maximum limit is the amount of credits that may be claimed per fiscal year.⁷

Qualified active low-income community businesses

Under federal law, a "qualified active low-income community business" is any partnership or corporation that, for any tax year, satisfies all of the following:

⁴ R.C. 5725.33. Current law limits the credit from being claimed for investments made before January 1, 2010. The bill eliminates reference to the date, theoretically allowing the credit to be claimed for investments made before that date. However, consistent with the rule of construction that a statute is presumed to be prospective in its operation unless expressly made retrospective, the bill would not appear to allow a credit for investments made before January 1, 2010. R.C. 1.48.

⁵ R.C. 5725.33(B)(2).

⁶ R.C. 5725.33(B)(2).

⁷ R.C. 5725.33(C).

(1) At least 50% of total gross income of the entity is derived from the active conduct of qualified business within a low-income community;

(2) A substantial portion of the use of the tangible property of the entity (whether owned or leased) is within a low-income community;

(3) A substantial portion of the services performed for the entity by its employees are performed in a low-income community;

(4) Less than 5% of the average of the aggregate unadjusted bases of the property of the entity is attributable to collectibles (other than collectibles held primarily for sale in the ordinary course of business);

(5) Less than 5% of the average of the aggregate unadjusted bases of the property of the entity is attributable to nonqualified financial property.⁸

Current Ohio law also requires that the business derive less than 15% of its annual revenue from the rental or sale of real property. The bill removes this additional requirement, making the Ohio definition of a "qualified active low-income community business" identical to the federal definition.

Retaliatory tax

Under current law, a foreign insurance company is authorized to claim the Ohio New Markets Tax Credit against the foreign insurance company franchise tax. In addition to the franchise tax, a foreign insurance company may be subject to a "retaliatory" tax, which is levied on insurance companies organized in a state whose insurance franchise tax rate as charged against Ohio insurance companies exceeds the tax rate charged in Ohio against that other state's companies. The rate of the retaliatory tax is the difference between that state's and Ohio's insurance franchise tax rate.⁹

The bill provides that a reduction in the amount of a foreign insurance company's insurance franchise tax as the result of the company claiming the Ohio New Markets Tax Credit does not increase that company's retaliatory tax liability.¹⁰

⁸ R.C. 5725.33(A)(4) and 26 U.S.C. 45D (2012). Nonqualified financial property is financial property (debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property) that is not working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less; or accounts or notes receivable acquired in the ordinary course of business for services rendered, or from the sale of stock or inventory in the taxpayer's ordinary course of business.

⁹ R.C. 5729.06.

¹⁰ R.C. 5729.16.

Certification process

Under current law, a qualified CDE is required to designate equity investments it holds as qualified equity investments for the purpose of qualifying for the federal and Ohio New Markets Tax Credit.¹¹ The bill removes the requirement that a qualified CDE designate such investments and instead requires that, before a qualified CDE may claim an Ohio credit, a qualified CDE must apply to the Director of Development, who must certify that the qualified CDE's equity investments are qualified equity investments. The Director must certify such investments, up to the \$50 million annual credit limit (see "**Credit limits**," above), according to the date that the Director receives completed applications from qualified CDEs, with applications received on earlier dates receiving certification before those received on later dates.

The Director must designate a date to begin evaluating applications. Any applications received by the Director before the designated date will be deemed to have been submitted on that date. An application must include the following:

(1) Evidence that the applicant is a qualified CDE and of the entity's Ohio service area;

(2) A copy of the allocation agreement between the qualified CDE and the federal Community Development Institutions Fund, the federal agency that certifies CDEs and determines allocations for purposes of the federal credit, and certification from the applicant affirming that the agreement remains in effect;

(3) A description of the proposed amount, structure, purchaser, and use of proceeds from the qualified equity investment;

(4) The identity of the investor who would be eligible to claim a credit upon the issuance of the investment; and

(5) A nonrefundable application fee of \$5,000 payable to the Department of Development.

A qualified CDE may apply to certify any amount of qualified equity investment, so long as the amount would not by itself cause the \$50 million annual credit limit to be exceeded. The Director must certify qualified equity investments according to the date the Director receives applications. Applications received on earlier dates will be certified before applications received on later dates.

¹¹ R.C. 5725.33(A)(5)(c) and (A)(6)(c). Federal law continues to require CDEs to so designate their investments.

If the Director receives an application that as fully certified would cause the credit limit to be exceeded, the Director may only certify the portion of the investment up to this credit limit for the fiscal year. The qualified CDE may accept the reduced certification or withdraw its application.

If the Director receives two or more completed applications on a single date, and the Director's certification of all the investments would cause the credit limit to be exceeded, the Director must certify those investments in proportion to the remaining amount available below the credit limit compared to the total investments requested to be certified on that date. A qualified CDE may accept reduced certification or withdraw its application. If the qualified CDE withdraws its application, the Director must recalculate the proportion to be awarded to the remaining applications received on that date.

The Director must approve or deny all or a part of an application within 30 days after receiving the application. If the Director denies any part of the application, the Director must inform the applying qualified CDE of the reason for the denial. If the qualified CDE revises or supplements its application so that the application is complete within 15 days after receiving such notice, the Director shall deem the qualified CDE's application submitted as of the date the Director first received the application. If the qualifying CDE fails to provide necessary information in that 15-day period, the application remains denied, but the qualified CDE may reapply to have its proposed qualified equity investment certified.

If the Director certifies all or a portion of a proposed equity investment as a qualified equity investment, the qualified CDE must, within 30 days of receiving the notice, issue the qualified equity investment and receive cash in the amount so certified. The qualified CDE must then submit evidence to the Director of its receipt of such cash within ten days of such receipt. After the conclusion of the 30-day period, the qualified CDE may claim the credit to which it is entitled. If the qualified CDE does not issue the investment and receive cash within the 30-day period, then the Director must withdraw the Director's certification and provide written notice of the withdrawal to the qualified CDE, which may reapply to have its proposed qualified equity investment certified. If the withdrawn amount was proposed by a qualified CDE that applied on the same date as other qualified CDEs that collectively had their certified qualified equity investments reduced as a result of the proportional reduction, the Director must allocate the withdrawn amount among other qualified CDEs' investments by reapplying the proportional reduction to the remaining qualified investments. Otherwise, the

withdrawn amount is awarded to qualified CDEs that applied for certification on later dates.¹²

Continuing law grants the Department of Development the authority to promulgate rules to determine how credits are awarded. The bill, by prescribing specific certification procedures, could require the Department to amend its current rules prescribing the process of applying for and approving credits.¹³

Noncompliance cure period

Under current law, an insurance company or financial institution is required to repay credits if the issuing CDE is no longer a qualified CDE, substantially all (85%) of the cash is not used by the CDE to make qualified low-income community investments, or the investment is redeemed before the end of the seven-year credit period (except that in the seventh year, only 75% of the purchase price must be used for qualified low-income community investments).

The bill requires the Director of Development to give an insurance company or financial institution that does not comply with qualified CDE requirements written notice of its noncompliance and allow the company or institution six months to cure such noncompliance before the Director takes formal action to recapture any or all claimed credit.¹⁴

Qualified equity investment

Similar to current law, the bill requires that, for an equity investment in a qualified CDE to be a qualified equity investment eligible for the credit, at least 85% of such investment's purchase price must be used by the CDE to make qualified low-income community investments. However, current law does not expressly state how long the CDE has to meet this 85% investment after receiving the taxpayer's investment in order for the investment to be certified (see "**Certification process**," above) as a qualified equity investment.

The bill specifies that the 85% investment threshold must be satisfied within one year after the taxpayer makes the investment in the CDE. This accords with federal regulations.¹⁵

¹² R.C. 5725.33(D).

¹³ R.C. 5725.33(E); O.A.C. 122:22-1.

¹⁴ R.C. 5725.33(E), 5729.16(D), and 5733.58(D).

¹⁵ R.C. 5725.33(A)(6)(b).

Pass-through treatment

The bill specifies that a credit allowed to a pass-through entity may be allocated to the owners of the entity for each owner's direct use in accordance with any agreement between such owners.

HISTORY

ACTION	DATE
Introduced	04-12-12

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