Ohio Legislative Service Commission

Bill Analysis

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Sub. S.B. 327*

129th General Assembly

(As Reported by S. Ways & Means & Economic Development)

Sens. Beagle and Tavares, Seitz

BILL SUMMARY

- Divides Ohio's New Markets Tax Credit into two separate programs – the New Markets Revitalization Tax Credit ("Revitalization Credit") and the New Markets Expansion Tax Credit ("Expansion Credit").
- Increases the annual limit on the total amount of credits that may be awarded per fiscal year from $10 million to $50 million, and divides the overall limit to allow $15 million of Revitalization Credits and $35 million of Expansion Credits to be claimed per fiscal year.
- Increases the limit on the amount of credit-eligible investments that a qualified low-income community business may receive in a fiscal year, from $2,564,000 to $4 million under the Revitalization Credit program or $10 million under the Expansion Credit program.
- Accelerates, with respect to the Revitalization Credit, an investor's receipt of a credit by permitting credits equal to 5% of a qualified investment for each of the first three years of the seven-year credit period and 6% for each of the final four years.
- Maintains the current law credit allocation process with respect to Revitalization Credits, but prescribes a new application process for certification of credit-eligible investments under the Expansion Credit program.
- Allows credit-eligible investments to be made in low-income community businesses that derive 15% or more of their annual revenue from renting or selling real estate under the Revitalization Credit program, but maintains current law's prohibition on

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* This analysis was prepared before the report of the Senate Ways and Means and Economic Development Committee appeared in the Senate Journal. Note that the list of co-sponsors and the legislative history may be incomplete.

the credit eligibility of such investments with respect to the Expansion Credit program.

- Prevents the credit from increasing the retaliatory tax paid by certain foreign insurance companies.

- Specifies new rules for the recapture of credits and 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.

CONTENT AND OPERATION

New Markets Tax Credit

Current law authorizes a nonrefundable New Markets Tax Credit against the insurance and financial institution franchise taxes for entities that purchase and hold securities issued to finance investments in businesses located in low-income communities in Ohio. The credit is based largely on the federal New Markets Tax Credit.[1]

Federal credit

Federal law provides a New Markets Tax 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]

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[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.

Changes to Ohio's New Markets Tax Credit

Under current law, the Ohio New Markets Tax Credit is a single tax credit available to insurance companies and financial institutions. The bill divides the credit into two separate credit programs with distinct standards and application procedures – the New Markets Revitalization Tax Credit ("Revitalization Credit") and the New Markets Expansion Tax Credit ("Expansion Credit").[4]

Credit amount

Current law allows an investor to claim an Ohio New Markets Tax Credit equal to 39% of the "adjusted purchase price" of the investor's qualified low-income community investments. Under the federal NMTC program, a CDE can make qualified investments in any state. For purposes of the Ohio credit, the "adjusted purchase price" of a qualified investment is the portion of the cost of that investment that can be apportioned to Ohio (based on the percentage of the CDE's investments that are made in Ohio businesses).

The bill maintains the current law formula for the purposes of calculating the amount of an investor's Revitalization Credit, but provides that an investor may claim an Expansion Credit equal to 39% of the full cash price of a qualified investment, rather than only the portion of the investment that is apportioned to Ohio.[5] (However, under a separate requirement, a credit is allowed for a qualified investment only if at least 85% of the proceeds of the investment are made in Ohio businesses. See, "**Qualified equity investment**," below.)

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. Under current law, no credit may be applied in the first two years. Then, an amount equal to 7% of the qualified investment may be applied for the third year and 8% for each of the remaining four years, for a total credit of 39%.[6] The bill continues this schedule with respect to the Expansion Credit program, but accelerates the schedule with respect to the Revitalization Credit. Under the latter program, an investor may

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[4] R.C. 5725.33 and 5725.331.

[5] R.C. 5725.33(B) and 5725.331(B).

[6] 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.

instead claim a credit equal to 5% of the qualified investment in each of the first three years and 6% in each of the final four years.

Qualified equity investment

A qualified equity investment is an equity investment by an insurance company or financial institution in a qualified CDE. To be a qualified investment under current law, the CDE must designate the investment as a qualified equity investment and invest at least 85% of the purchase price of the investment in qualified low-income community investments. This 85% investment-level threshold must be maintained throughout the credit allowance period, except that, in the seventh year after the investment is made, the threshold is lowered to 75%.

Current law does not expressly state how long the CDE has to meet the 85% threshold after receiving a taxpayer's investment. The bill specifies that, to qualify for the Revitalization Credit program, the 85% threshold must be satisfied within one year after the taxpayer and the Director of Development Services entered into a credit agreement with respect to the investment. (This one-year time frame is already required under Development Service Agency regulation.) To qualify for the Expansion Credit program, the 85% investment threshold must be satisfied within one year after the taxpayer receives notice of the Director of Development Services' certification of the investment as a "qualified equity investment" (see "**Certification process**," below).[7]

Qualified Community Development Entity

Under current Ohio law, a qualified CDE includes only CDEs that have a "service area" in Ohio and that have entered into a credit agreement with respect to the federal NMTC. The bill clarifies that, with respect to both the Revitalization and Expansion Credits, a qualified CDE includes CDEs that have a current federal agreement or that have ever entered into such an agreement in the past. In addition, with respect to both of the bill's programs, an entity may qualify as a qualified CDE even if it does not itself meet the service area or federal agreement requirements, so long as it is controlled by, or under the common control of, an entity that does meet those requirements.[8]

Credit limits

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, but divides this overall limit

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[7] R.C. 5725.33(A)(5) and 5725.331(A)(5).

[8] R.C. 5725.33(A)(4).

to allow $15 million of Revitalization credits and $35 million of Expansion credits to be claimed per fiscal year.[9]

Current law also limits the amount of credit-eligible investments that a qualified low-income community business may receive in a fiscal year to $2,564,000. The bill increases this limit to $4 million for the Revitalization Credit program and to $10 million for the Expansion Credit program.[10]

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:

(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.[11]

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 maintains this requirement with respect to the Expansion Credit program, but removes the requirement with respect to the Revitalization Credit program. Consequently, the

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[9] R.C. 5725.33(C) and 5725.331(C).

[10] R.C. 5725.33(B)(2) and 5725.331(B)(2).

[11] 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.

Revitalization Credit definition of a "qualified active low-income community business" is 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.[12]

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.[13]

Certification process

Under current law, a qualified CDE is required to designate the equity investments it issues as qualified equity investments for the purpose of qualifying for the federal and Ohio New Markets Tax Credit.[14] The procedures and fees for applying for credits based on designated investments are prescribed in rules adopted by the Development Services Agency.

The bill maintains this scheme with respect to the Revitalization Credit program, but specifies that a qualified CDE need only designate investments as qualified equity investments for purposes of the state credit. With respect to the Expansion Credit program, the bill removes the requirement that a qualified CDE designate investments and instead requires the qualified CDE to apply to the Director of Development Services, who must certify that the qualified CDE's equity investments are qualified equity investments. The Director must certify such investments, up to the $35 million annual credit limit for the Expansion Credit (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.

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[12] R.C. 5729.06.

[13] R.C. 5729.16.

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

The Director must designate a date to begin evaluating applications for the Expansion Credit. 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) If the CDE has a current allocation agreement with the federal Community Development Institutions Fund (the federal agency that certifies CDEs and determines allocations for purposes of the federal credit), a copy of that agreement;

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

(4) A description of the proposed use of the proceeds from the investment if that information is then available;

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

(6) 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 $35 million annual Expansion 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.

If the Director receives an application for an Expansion Credit 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 Expansion Credit 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 under the Expansion Credit program, the qualified CDE must, within one year 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. If the qualified CDE does not issue the investment and receive cash within the one-year 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.[15]

Noncompliance cure period

Under current law, an insurance company or financial institution is required to repay a New Markets credit if a federal tax credit allowed for the same investment is recaptured under federal law or if the Director of Development Services finds that an investment is not a "qualified equity investment" or was not made in a qualified active low-income community business.

The bill instead requires taxpayers to repay a Revitalization or Expansion credit if a federal credit allowed for the same investment is recaptured, if all or a portion of the qualified equity investment is redeemed before the final credit allowance date, if at least 85% of the investment's purchase price is not invested in qualified low-income community investments within the one-year time frame prescribed for the credit program (see "**Qualified equity investment**," above), or if that 85% threshold (or the

[15] R.C. 5725.331(D).

75% threshold applicable to the seventh year) is not maintained until the final credit allowance date.

The bill also requires the Director of Development to give an insurance company or financial institution that does not comply with these requirements written notice of its noncompliance and to allow the company or institution six months to cure such noncompliance before the Director takes formal action to recapture any or all claimed credit.[16]

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 an agreement between such owners or in proportion to each owner's interest in the entity.[17]

HISTORY

ACTION	DATE
Introduced	04-12-12
Reported, S. Ways & Means & Economic Development	---

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[16] R.C. 5725.33(D), 5729.16(D), and 5733.58(D).

[17] R.C. 5725.33(E) and 5725.331(E).