

# HOUSE RESEARCH

## Bill Summary

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### Overview

This bill allows a state new markets credit that is similar in qualifying criteria and allowance to the federal new markets credit. The credit is targeted at encouraging investments in low-income community development projects. Under the bill the Department of Employment and Economic Development (DEED) would allocate tax credit authority to community development entities that serve as financial intermediaries. They, in turn, sell the credits to insurance companies and use the proceeds received to make investments in active low-income community businesses.

The bill authorizes up to \$250 million in authorized investments. Since the tax credit rate is 39 percent, this could result in reduced tax collections of up to \$97.5 million. The tax credit is allowed to insurance companies that pay the insurance premiums tax. The credit allowance is spread over a 7-year period, but no credit is claimed in the year the investment is made or the following year, so the revenue reduction is delayed until the third year after the program begins (2017).

### Section

- 1 **Title.** Provides the title of the statutory chapter is the “Minnesota New Markets Jobs Act.”
- 2 **Definitions.** Defines terms for purposes of the new markets tax credit statute. These include:
  - **Affiliate** is to be determined by considering all the relevant facts and circumstances related to an equity investment. In making this determination all of the information provided in the application is assumed to be true. Affiliates specifically include any

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entity that holds an equity investment in the qualified community development entity and any entity that provides insurance or a guarantee to a recipient of the tax credit.

- **Applicable percentage** is used to determine the percentage rate of the credit for each taxable year under section 3**Error! Reference source not found.** It is 0 for years 1 and 2; 8 percent for years 3 to 6; and 7 percent for year 7. Thus, the total credit percentage is 39 percent ( $8\% * 4 + 7\% = 39\%$ ).
- **Code** means the version of the Internal Revenue Code that applies to the Minnesota income and corporate franchise taxes under chapter 290.
- **Credit allowance date** means the day on which the qualifying equity investment was made and that day of each of the six succeeding calendar years.
- **Department** means the Department of Employment and Economic Development (DEED).
- **Long-term debt security** means a debt security issued by a qualified community development entity that meets the following requirements. (These limits are designed to prevent debt from being used to transfer the credit to holders of the debt before the 7-year term of the credit is up.):
  - Must be issued at par value
  - Have a minimum maturity of 7 years (i.e., the same term as the tax credit)
  - Prohibit acceleration or prepayment, except if the issuer defaults
  - Cannot allow for cash interest payments during the credit allowance period (first seven years) that exceed cumulative operating income as defined by federal law.
- **Purchase price** is the amount paid to the issue for a qualified equity investment.
- **Qualified active low-income community businesses** are the businesses that can benefit from an investment that qualifies for the tax credit. These businesses must meet the requirements of the federal credit. A business does not qualify if it receives 15 percent or more of its revenue from rental or sale or real estate. However, this restriction doesn't apply, if the credit benefits a controlled tenant of the entity who rents the real estate.
- **Qualified community development entity** is defined by reference to federal law. To qualify an entity must have an agreement with the U.S. Treasury Department allocating it a federal credit for investments located in Minnesota. Subsidiary or affiliated entities are treated as one for purposes of the application. Financial institutions do not qualify unless they are chartered or headquartered in Minnesota.
- **Qualified equity investment** means an equity investment in or a long-term debt security issued by a qualified community development entity after January 1, 2014. The securities must be purchased for cash, all of which is used to invest in qualified active low-income community businesses. The investment cannot qualify for federal new markets tax credits if the proceeds are used to make investments in other qualified community development entities.

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- **Qualified low-income community investment** means an investment or loan to a qualified active low-income community business. A \$5 million limit applies to the investments that can be made in one qualified active low-income community business, including investments made by different qualified community development entities.
- **Refundable performance fee** is the fee (equal to 0.5 percent of the equity investment) a qualified community development entity is required to pay to DEED to assure it complies with the credit’s legal requirements.
- **State premium tax liability** is the insurance premium tax paid under chapter 297I.

**3 Credit established.** Allows an insurance company that purchases a qualified equity investment to claim a credit against its premium tax liability. (This includes the retaliatory tax that a foreign insurance company may be subject to because its state of domicile imposes a higher insurance tax than Minnesota does.) The amount of the credit equals the applicable percentage for the year multiplied by the amount of the investment. The table below shows the credit rates (this is derived from the definition of “applicable percentage” in section 2):

<b>Years after the investment is made</b>	<b>Applicable percentage</b>
0	0
1	0
2	8%
3	8%
4	8%
5	8%
6	7%

If the credit exceeds the insurance company’s liability for tax, the excess is a carryforward to later tax years. There is no limit on the length of the carryforward.

**4 Transferability.** Provides that the tax credits are not refundable and may not be sold on “the open market.” However, an investor may transfer credits to an affiliated insurance company and a partnership or LLC may allocate the credits to partners or members (this authority provides de facto transferability to “tax credit partners” or shareholders). Notification of a transfer to an affiliated insurance company must be provided to DEED in writing.

**5 Certification of qualified equity investments.** Authorizes qualified community development entities to apply to DEED for tax credits. DEED is required to begin accepting applications by October 1, 2015. Applications must include:

- Evidence that the entity is certified by the U.S. Treasury Department as a qualified entity for locations in Minnesota
- A copy of the federal allocation agreement and certification that the allocation remains in effect

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- Evidence that it has received more than one federal allocation and at least one after January 1, 2015
- Evidence that it has made \$50 million or more of investments under the federal or other state credits
- A description of the qualified investment
- The minimum allocation that the applicant is willing to accept
- Description of the plan for use of the funds
- A nonrefundable application fee of \$5,000 and the refundable performance fee (described in the summary of section 2)

The department is directed to grant or deny the application within 30 days. The department must inform the applicant of the reason for any denial of the application or if accepted, notify the applicant in writing of the certification. The qualified community development entity must notify DEED in writing of the entities eligible to claim the credits, including any changes as a result of transfer to an affiliate.

The section authorizes DEED to certify \$250 million in investments. (This could generate up to \$97.5 million in tax credits, given the 39 percent credit rate.) DEED is required to award the credits to qualifying applications on a first-come-first-served basis. Approved community development entities can transfer their authority to controlling or subsidiary entities. The approved entities are to issue the securities and obtain cash investments within 60 days after approval and to notify DEED with ten days after they receive the cash. If they don't receive the investment within the 60-day period, the certification lapses and DEED may reissue that amount.

**6 Disallowance of tax credits and penalties.** Provides for proportionate disallowance of the tax credits if the issuer (the qualified community development entity):

- Redeems or makes a principal repayment of the investment;
- Fails to invest all of the proceeds in a qualified low-income community investment in Minnesota and maintains the investment for six years; or
- Uses the proceeds for a prohibited purpose.

Recapture does not apply to tax credits already claimed by the insurance companies that made the investment.

**7 Notice of noncompliance.** Allows an entity six months to cure a notice of the disallowance of a tax credit under section 6.

**8 Refundable performance fee.** Requires payment of the refundable performance fee (defined in section 2). The fee is deposited in a new account established for that purpose in the special revenue fund. The fee is forfeited to the state if:

- The entity fails to issue the full certified amount of the qualified equity investments (entire fee)
- The proceeds of the equity investments are not used to making qualifying low-income community investment (same proportion of the fee as the proportion that was not

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used to make investments). The six-month cure period under section 7 applies to these forfeitures.

Once compliance with the law's requirements is established, the qualified community development entity is entitled to a refund of the performance fee within 30 days.

- 9** **Preapproval of investments.** Authorizes a qualified community development entity to request a written determination from DEED as to whether an investment qualifies for the credit. DEED is required to respond within ten days and is bound by the determination.
- 10** **Prohibited use of proceeds.** Prohibits a qualified low-income community business entity that receives an investment qualifying for the credit from using the proceeds of the investment to lend or invest in a qualified community development entity.
- 11** **Reporting.** Requires a qualified community development entity that receives credit allocations to report to DEED within 30 days of each credit allowance date:
- A list of the businesses in which it has invested, including of each business, its location, and employment information
  - Bank records showing that it has complied with the tax credit requirements (i.e., making timely investments of all of the allocated amounts)
  - Verification that it has no redeemed equity (or received principal repayments of debt) in violation of the tax credit's requirements
  - Any information related to recapture of the federal credit since the last report
- DEED is required to annually report to the legislature on the entities that have received allocations.
- 12** **Effective date.** Effective day following final enactment and premium tax returns due after that date. However, the definition of "applicable percentage" in section 1 will prevent tax credit allocations from reducing premium tax collections prior to returns filed for premiums due in 2017.