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BILL ANALYSIS

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Senate Bills 1625 through 1628 (as introduced 11-12-08)
Sponsor: Senator Randy Richardville (S.B. 1625 & 1628)
Senator Alan Sanborn (S.B. 1626 & 1627)
Committee: Finance

Date Completed: 12-3-08

CONTENT

Senate Bills 1625 and 1626 would amend the Michigan Business Tax (MBT) Act and the Income Tax Act, respectively, to allow a taxpayer holding a qualified equity investment issued by a qualified community development entity (CDE) to claim a credit over seven years against the MBT, the income tax, or the insurance retaliatory tax, beginning with the 2010 tax year, for a percentage of the purchase price paid to the CDE for the investment. The bills would do the following:

- Limit the total amount of approved credits to \$20.0 million, excluding carried-forward amounts from credits approved in a previous year.
- Require a qualified CDE to apply to the Department of Treasury for certification that an equity investment or long-term debt security was a qualified equity investment.
- Require a CDE, within 30 days after receiving notice of certification, to issue the qualified equity investment and receive cash in the amount certified.
- Require a CDE to use at least 85% of the cash purchase price of a qualified equity investment to make qualified low-income community investments in the State.
- Require the Department to recapture a credit under certain circumstances.
- Provide that a credit would not be refundable or transferable, except as

allowed for allocations among partners, members of a limited liability company, or shareholders in a subchapter S corporation.

The bills would define terms in the legislation and would adopt several definitions under Section 45D of the Internal Revenue Code (which provides for a "new markets tax credit" against the Federal income tax).

Senate Bill 1627 would amend the Insurance Code to allow an insurer to claim a credit against the insurance retaliatory tax for a qualified equity investment under the MBT Act.

Senate Bill 1628 would amend the revenue Act to require the Department of Treasury to report to the Legislature annually on the Department's activities regarding the new markets credits.

Senate Bills 1627 and 1628 are tie-barred to Senate Bill 1625. All of the bills are described in more detail below.

Senate Bills 1625 and 1626**Tax Credit & Definitions**

Senate Bill 1625 would add Section 465 to the MBT Act and Senate Bill 1626 would add Section 279 to the Income Tax Act. Under each bill, subject to the limit on the total amount of approved credits, for the 2010 tax year and each subsequent tax year, a qualified taxpayer holding a qualified equity

investment on a credit allowance date of that investment, could claim a credit against the MBT, the income tax, or the insurance retaliatory tax. The credit would equal the applicable percentage of the purchase price paid to the qualified CDE for the qualified equity investment.

The credit could not exceed the taxpayer's tax liability for the tax year. The excess amount of the credit and any unused carryforward of the credit could not be refunded or transferred, except as provided for allocating the credit, but could be carried forward to offset tax liability in subsequent tax years.

Tax credits earned by a partnership, limited liability company, or subchapter S corporation could be allocated to its partners, members, or shareholders for their direct use in accordance with any agreement among them.

A "qualified taxpayer" would be a taxpayer liable under the MBT Act or the Income Tax Act, or liable for the insurance retaliatory tax.

"Credit allowance date" would mean the date on which the qualified equity investment is initially made and each of the six subsequent anniversary dates of that date. "Applicable percentage" would mean 0% for each of the first two credit allowance dates, 7% for the third credit allowance date, and 8% for the next four credit allowance dates.

"Qualified community development entity" would have the meaning given to that term in Section 45D of the Internal Revenue Code (IRC), provided that the entity has entered into, or is controlled by a qualified CDE that has entered into, an allocation agreement with the Community Development Financial Institutions Fund of the U.S. Treasury Department with respect to credits authorized by Section 45D. The allocation agreement would have to include the State of Michigan within the service area set forth in the agreement. (Under Section 45D, a "qualified community development entity" is a domestic corporation or partnership whose primary mission is serving, or providing investment capital for, low-income communities or low-income people; that maintains accountability to residents of low-income communities through their representation on any governing board of

the entity or advisory board to it; and that is certified by the U.S. Treasury Secretary.)

"Qualified equity investment" would mean any equity investment in, or long-term debt security issued by, a qualified CDE that meets all of the following criteria:

- Is acquired after the bill's effective date at its original issuance solely in exchange for cash.
- Has at least 85% of its cash purchase price used by the CDE to make qualified low-income community investments in this State.
- Is designated by the CDE as a qualified equity investment.
- Is certified by the Department as not exceeding the limit on total credits.

"Qualified low-income community investment" would mean any capital or equity investment in, or loan to, any qualified active low-income community business made after the bill's effective date. With respect to any one low-income community business, the maximum amount of qualified low-income community investments made in that business, on a collective basis with all of its affiliates that could be counted toward satisfying the minimum 85% cash purchase price used by the issuer to make qualified low-income community investments in Michigan, would be \$10.0 million whether issued to one or several qualified CDEs.

"Qualified active low-income community business" would have the meaning given to that term in Section 45D of the IRC, except that any business that derives or projects to derive 15% or more of its annual revenue from the rental or sale of real estate would not be considered to be a qualified active low-income community business unless it is controlled by, or under common control with, another business that does not derive or project to derive 15% or more of its annual revenue from real estate and is the primary tenant of the real estate leased from the initial business. (The definition in Section 45D refers to any corporation or partnership if at least 50% of its total gross income is derived from the active conduct of a qualified business entity within any low-income community; a substantial portion of the entity's tangible property is used within any low-income community; a substantial portion of the services performed for the entity by its employees is performed in any low-income community; and less than 5% of

the average of the aggregate unadjusted bases of the entity's property is attributable to collectibles other than those held primarily for sale to customers in the ordinary course of business, and is attributable to nonqualified financial property.)

"Long-term debt security" would refer to any debt instrument issued by a qualified CDE with an original maturity date of at least seven years, meeting other criteria of the definition.

Certification; Issuance of Investment

A qualified CDE that sought to have an equity investment or long-term debt security designated as a qualified equity investment and eligible for tax credits would have to apply to the Department for certification. A qualified taxpayer could not claim a credit unless the CDE had submitted an application and the Department had issued a certification to the CDE.

The certification would have to state the following:

- That the applicant was a qualified CDE.
- That the equity investment or long-term debt security was a qualified equity investment.
- The proposed dollar amount of the qualified equity investment.

The Department would have to certify qualified equity investments in the order applications were received. Applications received on the same day would have to be considered received simultaneously. For complete applications received on the same day, the Department would have to certify qualified equity investments and, if insufficient tax credit capacity remained, reduce the amount of certified qualified equity investment in proportionate percentages based on the ratio of the amount requested in an application to the total amount requested in all applications received that day.

Within 30 days after receiving notice of certification, the qualified CDE would have to issue the qualified equity investment and receive cash in the amount of the certified amount. The CDE would have to give the Department evidence of receipt of the cash investment within 10 business days after receipt. If the CDE did not meet the 30-day deadline, the certification would lapse and

the entity could not issue the qualified equity investment without reapplying to the Department for certification.

Recapture

The Department would have to recapture the credit from a qualified taxpayer if the amount of the Federal tax credit available with respect to a qualified equity investment eligible for a credit under the bills were recaptured under Section 45D of the IRC. In that case, the Department's recapture would be proportionate to the Federal recapture with respect to that investment.

The Department also would have to recapture the credit if the issuer redeemed or made principal repayment with respect to a qualified equity investment before the seventh anniversary of the issuance of the investment. In that case, the Department's recapture would be proportionate to the amount of the redemption or repayment with respect to the investment.

In addition, the Department would have to recapture the credit if the issuer failed to invest at least 85% of the cash purchase price in the qualified low-income community investments in this State within 12 months of the issuance of the qualified equity investment, and to maintain that level of investment in qualified low-income community investments in this State until the last credit allowance date for the investment.

A qualified equity investment would be considered held by a qualified CDE even if the investment had been sold or repaid, provided that the CDE reinvested an amount equal to the capital returned to or recovered by it from the original investment, excluding any profits realized, in another qualified low-income community investment in Michigan within 12 months after that the CDE received that capital.

A CDE would not be required to reinvest capital returned from qualified low-income community investments after the sixth anniversary of the issuance of the qualified equity investment, whose proceeds were used to make the qualified low-income community investment, and that investment would be considered held by the CDE through the seventh anniversary of the investment's issuance.

The Department would have to give notice to a qualified taxpayer and qualified CDE of any proposed recapture of tax credits, and the taxpayer or CDE would have 90 days to cure any deficiency and avoid recapture. If the taxpayer or CDE did not or could not cure the deficiency within 90 days, the Department would have to give the taxpayer or CDE a final order of recapture. Any tax credit for which a final order had been issued would have to be recaptured from the qualified taxpayer that claimed the tax credit.

Senate Bill 1627

Section 476a of the Insurance Code imposes what is called a "retaliatory tax" on foreign insurance companies doing business in Michigan, if the states where the foreign insurers are domiciled impose a tax on Michigan-based insurers doing business in those states that is greater than the tax that Michigan otherwise imposes on foreign insurers.

Under the bill, beginning on January 1, 2010, an insurer or agent of an insurer could credit against the retaliatory tax an amount equal to the amount of the credit the insurer or agent was eligible to claim for a qualified equity investment under Section 465 of the MBT Act.

Senate Bill 1628

The bill would require the Department of Treasury to report to both houses of the Legislature on October 1 on the Department's activities regarding the new markets credits authorized under Section 465 of the MBT Act, Section 279 of the Income Tax Act, and Section 476a of the Insurance Code. The report would have to include all of the following:

- The total amount of qualified equity investments attracted under those sections.
- The total number of qualified taxpayers that claimed a credit under those sections.
- The total amount of credits awarded.
- The total number of certificates issued to qualified CDEs.
- The amount and duration of the tax credit separately for each qualified taxpayer.

The report also would have to include the name and location of all qualified taxpayers and qualified CDEs, as well as the names

and addresses of corporate directors and officers, partners, or members of a limited liability company, as applicable.

Proposed MCL 208.1465 (S.B. 1625)
Proposed MCL 206.279 (S.B. 1626)
MCL 500.476a (S.B. 1627)
Proposed MCL 205.18a (S.B. 1628)

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

Senate Bills 1625, 1626, and 1627

The bills would reduce General Fund revenue and School Aid Fund revenue by \$20.0 million per year or less each year after 2010. For FY 2009-10, the impact would be less, with a maximum impact of approximately \$12.5 million. Senate Bills 1625, 1626, and 1627 are not all tie-barred to each other although the limit on the aggregate amount of the credits allowed would include credits granted under each of the bills. As a result, if some of the bills were not enacted, the credits available to be granted under the other bills would be increased. Credits under Senate Bills 1625 and 1627 would reduce General Fund revenue. The credits awarded under Senate Bill 1626 could affect School Aid Fund revenue to the extent that they were reflected at all in gross collections (such as withholding payments and estimated payments) because 23.3% of gross income tax collections are deposited into the School Aid Fund. To the extent that the value of the credits was reflected in annual returns or payments, the credits under Senate Bill 1626 would reduce General Fund revenue only. It is unknown how the credits would be distributed across the three taxes covered by the bills.

Senate Bill 1628

Any costs associated with the reporting requirements proposed in the bill should be absorbable within the Department of Treasury's current funding levels. No additional appropriations should be required to meet the requirements under the bill.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.