Legislative Analysis

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NEW MARKETS TAX CREDIT

House Bill 4175
Sponsor: Rep. Kate Ebli

House Bill 4176
Sponsor: Rep. Tim Melton

House Bill 4177
Sponsor: Rep. Jon Switalski

House Bill 4178
Sponsor: Rep. Robert Jones

Committee: Tax Policy
Complete to 2-24-09

A SUMMARY OF HOUSE BILLS 4175-4178 AS INTRODUCED 2-5-09

The package of legislation[1] would provide tax incentives for certain investments made in low-income communities, and is generally modeled after the federal New Markets Tax Credit.[2] Generally, under the bills, taxpayers are eligible to claim a credit for investments made in community development entities (CDEs), which use these investments to make investments in qualified low-income communities. The tax credit would be available against the Income Tax (HB 4175), the Michigan Business Tax (HB 4176), and the insurance retaliatory tax (HB 4175) beginning with the 2009 tax year.[3] The total amount of the credit, under all three taxes, is limited to $20 million annually.

House Bill 4175 (Income Tax Act) and House Bill 4176 (Michigan Business Tax Act)

The bills would amend the Income Tax Act and the Michigan Business Tax Act, respectively, as follows:

Community Development Entities (CDEs)
Investments eligible for the tax credit must be made in community development entities certified by the Department of Treasury. A qualified CDE, under the bill, would be a

[1] The bills are reintroductions of legislation offered last session and generally incorporate the House-passed versions. See HB 6428 (H-1), HB 6429 (H-1), HB 6430 (H-2), and HB 6431 (H-2) of the 94th Legislative Session. The bills passed the House on September 24, 2008.
[2] The New Markets Tax Credit was initially created with the enactment of the Community Renewal Tax Relief Act of 2000, H.R. 4577 (H.R 5662) of the 106th Congress (P.L. 106-554, Appendix G). For further information on the NMTC see Donald J. Marples, *New Markets Tax Credit: An Introduction*, Congressional Research Service, March 3, 2008. The report is available on the Internet at http://assets.opencrs.com/rpts/RL34402_20080303.pdf. See also *New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance*, Governmental Accountability Office, GAO-07-296, January 31, 2007, http://www.gao.gov/new.items/d07296.pdf. See also *New Markets Tax Credits: Unlocking Investment Potential,* U.S. Department of Treasury, Comptroller of the Currency, February 2007. http://www.occ.treas.gov/cdd/InsightsNMTC.pdf. The program is jointly administered by the Community Development Financial Institutions Fund (CDFIF) and the Internal Revenue Service (IRS), both organized within the U.S. Department of Treasury. See http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5. See generally 26 USC 45D and 26 CFR 1.45D-1.
[3] At least three other states currently provide a state-level NMTC. These include Louisiana (R.S. 47:6016), Mississippi (MS Code Sec. 99-233), and Missouri (RSMo 135.680).

qualified community development entity (as defined in the Internal Revenue Code)[4] that has entered into an allocation agreement (that includes Michigan in the service area) with the U.S. Department of Treasury, Community Development Financial Institutions Fund.[5] Under the IRC, a CDE is any domestic corporation or partnership that (1) has the primary purpose of serving, or providing investment capital for, low-income communities or low-income persons; (2) includes residents of low-income communities on its governing or advisory boards; and (3) is certified by the Community Development Financial Institutions Fund for the purposes of the NMTC program.

To be eligible for a credit, a CDE would have to submit an application for certification, accompanied by a $5,000 application fee, to the Department of Treasury. Once the CDE receives a notice of certification from the department, a CDE would generally have 30 days to issue qualified equity investments. Beyond that time period, if there is no investment activity, the certification would lapse and could be reissued by the department to another CDE.

Calculation of the state NMTC

Generally, the bills provide that a taxpayer that purchases a *qualified equity investment* (QEI) may claim a tax credit equal to the *applicable percentage* of the amount paid to the qualified CDE for the QEI. The credit would be nonrefundable and nontransferable, although it could be carried forward to offset tax liability in subsequent tax years. In the case of tax credits earned by a partnership, limited liability company, or Subchapter S corporation, the credit could be allocated to partners, members, or shareholders. In general a taxpayer may claim the credit over a seven-year period, although that period is limited by virtue of the limitations placed on the applicable percentage. The bill defines *applicable percentage* as 0% for the first two credit years, 7% for the third year, and 8% for the next four years.

Qualified Equity Investments

The bills define *qualified equity investments* to mean generally any equity investment in, or long-term debt security issued by, a qualified CDE acquired after July 1, 2009 by a taxpayer at its original issue solely in exchange for cash, and where 85% of the cash purchase price received by the qualified CDE is used to make *qualified low-income community investments*. In order to be eligible for the credit, the QEI would have to be certified by the Department of Treasury as not exceeding the $20 million limit on the credit. The department would approve the investments in the order in which they are received. If the amount of QEIs submitted to the department for certification exceeds the amount of any remaining credit authority, the credit for those QEIs would be prorated.

Under the bills, *long-term debt security* would generally mean any debt instrument issued by a qualified CDE, at par value or at a premium, with an original maturity date of at least seven years from the date of issuance, with no acceleration of repayment, amortization, or

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[4] See Section 45D(c) of the Internal Revenue Code, 26 USC 45D(c). See also the CDFIF's *Guidance for Certification of Community Development Entities, New Markets Tax Credit Program.* http://www.cdfifund.gov/docs/2002_nmtc_cde_certification_guidance.pdf

[5] The IRC, 26 USC 45D(f), as amended by the Tax Relief and Health Care Act of 2006 (P.L. 109-432), limits the total amount of credits to $3.5 billion in 2008, and allocates the credits among qualifying CDEs. A blank allocation agreement, issued for illustrative purposes, is available at http://www.cdfifund.gov/docs/2007/nmtc/NMTCProgram2007AATemplate.pdf.

prepayment prior to the original maturity, and no distribution, payment, or interest related to the profitability of the qualified CDE or its investment portfolio.[6]

Qualified Low-Income Community Investments

Investments in a qualified CDE are used by the CDE to make *qualified low-income community investments*, which the bills define as meaning any capital investment or equity investment in, or loan to, any *qualified active low-income community business* (QALICB) after July 1, 2009. The maximum investment in any one QALICB that is counted toward meeting the 85% minimum threshold for QEIs is $10 million, irrespective of the number of qualified CDEs receiving investments.

Under the bills, a QALICB would be given the same meaning as that term is defined in the Internal Revenue Code[7] except that it would not include any business that derives (or projects to derive) at least 15% of its annual revenue from the sale or rental of real estate. However, it could include such a business, if it is controlled by, or under common control with, another business that does not derive at least 15% of its annual revenue from the sale or rental of real estate and that is the primary tenant of the real estate leased from the initial business. Under the Internal Revenue Code, a QALICB is a for-profit or nonprofit corporation or a partnership that meets the following criteria in the tax year: (1) at least 50% of the total gross income is derived from the active conduct of a *qualified business* within any low-income community; (2) a substantial portion of the use of tangible property of the entity is within any low-income community; (3) a substantial portion of the services performed by the entity are in any low-income community; (4) less than 5% of the average of the aggregate unadjusted bases of the property is attributable to collectibles other than those that are held primarily for sale to customers in the ordinary course of business; and (5) less than 5% of the average of the aggregate unadjusted bases is attributable to nonqualified financial property (generally debt, stock, partnership interests, etc). A *qualified business* is generally any trade or business, although it does not include the rental of residential property or the operation of a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or a liquor store.[8]

Under the Internal Revenue Code, a *low-income community* is generally any population census tract where (1) the poverty rate is at least 20% or (2) the median family income is 80% or less than the statewide median family income (for census tracts not located within a metropolitan area) or the median family income is 80% or less of the greater of the statewide median family income or the metropolitan area median family income (for census tracts located within a metropolitan area).[9]

Recapture of the NMTC

The amount of the credit would be captured by the department for any of the following reasons: (1) if the federal NMTC is recaptured, the department would recapture a proportionate amount of the state NMTC; (2) the investment is redeemed prior to the seventh

[6] The bills do not define *equity investment* although, for reference, that term is defined in the federal NMTC statute, 26 USC 45D(b)(6), as any stock (other than nonqualified preferred stock) in a entity that is a corporation and any capital interest in an entity that is a partnership.
[7] 26 USC 45D(d)(2). See also 26 CFR 1.45D-1(d)(4).
[8] 26 CFR 1.45D-1(d)(5).
[9] 26 USC 45D(e).

anniversary of the date of issuance; or (3) the qualified CDE fails the 85% investment requirement for QEIs.

House Bill 4177 (Insurance Code)

The bill would amend Chapter 4 of the Insurance Code to specify that insurers and agents may claim a credit against the retaliatory tax by the amount the insurer or agent is eligible to claim for a qualified equity investment under the Michigan Business Tax (as amended by HB 4176).

House Bill 4178 (Revenue Act)

The bill would amend the Revenue Act to require the Department of Treasury to report to the legislature by July 1, 2013 and biannually thereafter on the status of the New Markets Tax Credit (NMTC). The report would include the following:

- Total amount of qualified equity investments.
- Total number of NMTC's claimed.
- Total number of NMTC's awarded.
- The amount and duration for each qualified taxpayer.
- The name and location of taxpayers and qualified community development entities seeking authorization for the state NTMC.

FISCAL IMPACT:

The bills would reduce retaliatory insurance tax, income tax, and MBT revenue by an unknown amount, although the bills impose a combined maximum credit amount of $20 million per year. To the extent the bills reduced retaliatory insurance tax and MBT revenue, the impact would fall directly on the General Fund. Assuming that income tax filers did not change withholding elections in anticipation of the credit, all of the income tax revenue reduction would also fall on the General Fund.

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