

## **BILL ANALYSIS**

Senate Research Center

H.B. 2061  
By: Murphy et al. (Hancock)  
Economic Development  
5/16/2013  
Engrossed

### **AUTHOR'S / SPONSOR'S STATEMENT OF INTENT**

Access to private sector capital for job-creating small businesses in economically distressed areas of Texas is a persistent problem that was exacerbated by the recent recession and ensuing credit crisis. Economically distressed communities across Texas, including many rural areas of the state, are typically financially underserved. It can be very challenging to establish new business, grow existing businesses, and create jobs for Texans in these economically distressed areas. These are the areas of the state most in need of economic development.

H.B. 2061 encourages private sector investment in job creating businesses in economically distressed rural and emerging urban markets throughout Texas.

H.B. 2061 amends current law relating to a tax credit for investment in certain communities, imposes a monetary penalty, and authorizes a fee.

### **RULEMAKING AUTHORITY**

Rulemaking authority is expressly granted to the comptroller of public accounts of the State of Texas in SECTION 1 (Section 231.009, Insurance Code) and SECTION 2 of this bill.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Subtitle B, Title 3, Insurance Code, by adding Chapter 231, as follows:

#### CHAPTER 231. TAX CREDIT FOR INVESTMENT IN CERTAIN COMMUNITIES

##### SUBCHAPTER A. GENERAL PROVISIONS

Sec. 231.001. GENERAL DEFINITIONS. Defines "applicable percentage," "comptroller," "credit allowance date," "purchase price," and "state premium tax liability" for this chapter.

Sec. 231.002. DEFINITION: LONG-TERM DEBT SECURITY. (a) Defines, in this chapter, "long-term debt security" to mean a debt instrument issued by a qualified community development entity, at par value or a premium, with an original maturity date not earlier than the seventh year after the date on which the debt instrument is issued, with no acceleration of repayment, amortization, or prepayment features before its original maturity date.

(b) Prohibits the qualified community development entity that issues a long-term debt security from making cash interest payments on the security during the period beginning on the date on which the security is issued and ending on the final credit allowance date in an amount that exceeds the cumulative operating income, as defined by regulations adopted under Section 45D, Internal Revenue Code of 1986, of the qualified community development entity for that period before giving effect to the interest expense of the long-term debt security.

(c) Provides that this section does not limit the holder's ability to accelerate payments on a long-term debt security in situations where the issuer has defaulted

on covenants designed to ensure compliance with this chapter or Section 45D, Internal Revenue Code of 1986.

Sec. 231.003. DEFINITION: QUALIFIED ACTIVE LOW-INCOME COMMUNITY BUSINESS. (a) Defines, in this chapter, "qualified active low-income community business" to have the meaning assigned by Section 45D, Internal Revenue Code of 1986, and 26 C.F.R. Section 1.45D-1, except that the term is limited to those businesses that do not exceed the Small Business Administration size eligibility standards established by 13 C.F.R. Section 121.201 at the time the qualified low-income community investment is made.

(b) Provides that a business is considered a qualified active low-income community business for the duration of the qualified community development entity's investment in, or loan to, the business if the entity reasonably expects, at the time it makes the investment or loan, that the business will continue to satisfy the requirements for being a qualified active low-income community business, other than the Small Business Administration size standards, throughout the entire period of the investment or loan.

(c) Provides that a business that derives or projects to derive 15 percent or more of its annual revenue from the rental or sale of real estate is not a qualified active low-income community business for purposes of this chapter. Provides that this exclusion does not apply to a business that is controlled by, or under common control with, an affiliated entity if the affiliated entity does not derive or project to derive 15 percent or more of its annual revenue from the rental or sale of real estate and is the primary tenant of the real estate leased from the business.

Sec. 231.004. DEFINITION: QUALIFIED COMMUNITY DEVELOPMENT ENTITY. Defines, in this chapter, "qualified community development entity" to have the meaning assigned by Section 45D, Internal Revenue Code of 1986, provided that the entity has entered into, for the current year or any prior year, an allocation agreement with the community development financial institutions fund of the United States Department of the Treasury with respect to credits authorized by Section 45D, Internal Revenue Code of 1986, that includes this state in the service area set forth in the allocation agreement. Provides that the term includes a qualified community development entity that is controlled by or under common control with another qualified community development entity described by this section.

Sec. 231.005. DEFINITION: QUALIFIED EQUITY INVESTMENT. (a) Provides that an investment or security is a "qualified equity investment" for purposes of this chapter if:

(1) the investment or security is an equity investment in, or long-term debt security issued by, a qualified community development entity;

(2) the investment or security is acquired on or after October 1, 2013, at its original issuance solely in exchange for cash;

(3) not later than the first anniversary of the initial credit allowance date at least 100 percent of the investment's or security's cash purchase price is used by the issuer to make qualified low-income community investments in qualified active low-income community businesses located in this state; and

(4) the investment or security is designated by the issuer as a qualified equity investment under this section and is certified by the comptroller as not exceeding the limitation provided by Section 231.104.

(b) Provides that qualified equity investment includes an investment or security that does not satisfy the requirements of Subsection (a) if the investment or security was a qualified equity investment in the hands of a prior holder.

Sec. 231.006. DEFINITION: QUALIFIED LOW-INCOME COMMUNITY INVESTMENT. Defines, in this chapter, "qualified low-income community investment" to mean a capital or equity investment in, or loan to, a qualified active low-income community business with respect to which a federal qualified low-income community investment of some amount is made concurrently with the investment or loan.

Sec. 231.007. DEFINITION: QUALIFIED INVESTOR. Defines, in this chapter, "qualified investor" to mean an entity that makes a qualified equity investment as defined by Section 231.005, or an entity that is allocated premium tax credits under Section 231.052(b).

Sec. 231.008. NEW MARKETS PERFORMANCE GUARANTEE ACCOUNT. Provides that the new markets performance guarantee account is established as a special account outside the state treasury. Requires the comptroller of public accounts of the State of Texas (comptroller) to administer the account and to deposit a refundable performance deposit received from a qualified community development entity under Subchapter E into the account.

Sec. 231.009. RULES AND STANDARDS. (a) Authorizes the comptroller to adopt rules as necessary to implement the duties of the comptroller under this chapter.

(b) Authorizes the comptroller, acting as the administrator, to:

(1) by rule set limits and restrictions on the use of the proceeds raised by a qualified community development entity, consistent with Section 45D, Internal Revenue Code of 1986;

(2) review or audit the investments of a qualified community development entity on a periodic basis;

(3) establish limits on the formation and syndication costs of a qualified community development entity and the entity's debt instruments;

(4) consistent with practices under Section 45D, Internal Revenue Code of 1986, establish limits of a qualified community development entity's operating expenses, including legal fees, loan sourcing or origination fees, loan servicing fees, management fees paid to affiliated firms, including non-Texas-based firms, organizational and formation expenses, and performance bonds; and

(5) limit any original issue discount on a debt instrument issued by a qualified community development entity.

#### SUBCHAPTER B. TAX CREDIT

Sec. 231.051. CREDIT ESTABLISHED. (a) Provides that, subject to Section 231.052(b), a qualified investor that makes a qualified equity investment earns a vested right to credit against the qualified investor's state premium tax liability.

(b) Authorizes the qualified investor, or a subsequent holder of the qualified equity investment, on each credit allowance date of a qualified equity investment, to claim a portion of the credit during the tax year of that credit allowance date.

(c) Provides that the credit amount is equal to the applicable percentage for the credit allowance date multiplied by the purchase price paid to the issuer of the qualified equity investment.

(d) Prohibits the amount of the credit claimed by a qualified investor from exceeding the amount of the qualified investor's state premium tax liability for the

tax year for which the credit is claimed. Authorizes any amount of tax credit that the qualified investor is prohibited from claiming in a tax year as a result of this subsection to be carried forward for use in a subsequent tax year.

Sec. 231.052. TRANSFERABILITY. (a) Provides that a premium tax credit claimed under this chapter is not refundable or salable.

(b) Authorizes a premium tax credit earned by or allocated to a partnership, limited liability company, S corporation, or other pass-through entity to be allocated to the partners, members, or shareholders of the entity for their direct use in accordance with an agreement among the partners, members, or shareholders. Provides that an allocation under this subsection does not constitute a sale for purposes of this chapter.

Sec. 231.053. RETALIATORY TAX. (a) Provides that a qualified investor or a subsequent holder of a qualified equity investment claiming a premium tax credit under this chapter is not required to pay any additional retaliatory tax levied under Chapter 281 (Retaliatory Provisions) as a result of claiming that credit.

(b) Provides that, in addition to the exclusion provided by Subsection (a), a qualified investor or a subsequent holder of the qualified equity investment claiming a credit under this chapter is not required to pay any additional tax that may arise as a result of claiming that credit.

#### SUBCHAPTER C. CERTIFICATION OF QUALIFIED EQUITY INVESTMENTS

Sec. 231.101. APPLICATION FOR CERTIFICATION OF QUALIFIED EQUITY INVESTMENT. (a) Requires a qualified community development entity that seeks to have an equity investment or long-term debt security certified as a qualified equity investment eligible for premium tax credits under this chapter to apply to the comptroller, acting as administrator under this chapter, as provided by this section.

(b) Requires that an application under this section include the following:

- (1) evidence of the applicant's certification as a qualified community development entity, including evidence of the service area of the entity that includes this state;
- (2) a copy of an allocation agreement executed by the applicant, or its controlling entity, and the community development financial institutions fund;
- (3) a certificate executed by an executive officer of the applicant attesting that the allocation agreement remains in effect and has not been revoked or canceled by the community development financial institutions fund;
- (4) a description of the proposed amount and structure, and of the purchaser, of the qualified equity investment;
- (5) identifying information for a qualified investor that will earn premium tax credits as a result of the issuance of the qualified equity investment;
- (6) except as provided by Subsection (c), examples of the types of qualified active low-income community businesses in which the applicant, its controlling entity, or affiliates of its controlling entity have invested under the federal New Markets Tax Credit Program;
- (7) a nonrefundable application fee of \$5,000 to be paid to the comptroller; and

(8) except as provided by Section 231.201(c), the refundable performance deposit of \$500,000 required by Subchapter E.

(c) Provides that an applicant is not required to have invested under the federal New Markets Tax Credit Program, and an application is not required to include the examples described by Subsection (b)(6), if the application includes information in the form required by the comptroller demonstrating that the applicant, together with the applicant's controlling entity and the affiliates of its controlling entity:

(1) is a duly formed qualified community development entity;

(2) has total assets under management in the amount of \$250 million or less; and

(3) has a demonstrable track record of successfully investing in low-income communities, as defined by Section 45D, Internal Revenue Code of 1986.

Sec. 231.102. ACTION ON APPLICATION. (a) Requires the comptroller, not later than the 30th day after the date an application under Section 231.101 is received, to grant or deny the application in full or in part.

(b) Requires the comptroller, if the comptroller denies part of the application, to inform the applicant of the grounds for denial.

(c) Provides that, if the applicant provides additional information required by the comptroller or otherwise completes the application not later than the 15th day after the date of the notice of denial, the application is considered completed as of the date on which it was originally submitted. Provides that, if the qualified community development entity fails to provide the information or complete its application before that date, the application is denied and must be resubmitted in full and has a new submission date.

Sec. 231.103. CERTIFICATION OF QUALIFIED EQUITY INVESTMENT. (a) Requires the comptroller, if an application under Section 231.101 is granted under Section 231.102, to certify the proposed equity investment or long-term debt security as a qualified equity investment that is eligible for premium tax credits under this chapter, subject to Section 231.104.

(b) Requires the comptroller to provide written notice of the certification to the qualified community development entity.

(c) Requires that the notice include the names of those entities that will earn the credits and their respective credit amounts. Requires the qualified community development entity, if the names of the entities that are eligible to claim the credits change due to a transfer of a qualified equity investment or an allocation under Section 231.052, to notify the comptroller of the change.

(d) Requires the comptroller to certify qualified equity investments in the order in which applications are received by the comptroller. Provides that applications received on the same day are considered to have been received simultaneously. Requires the comptroller, for applications that are complete and received on the same day, to certify, consistent with remaining qualified equity investment capacity, the qualified equity investments in proportionate percentages based on the proportion that the amount of qualified equity investment requested in an application bears to the total amount of qualified equity investments requested in all applications received on the same day.

Sec. 231.104. LIMIT ON CERTIFIED INVESTMENTS. Authorizes not more than \$750 million in qualified equity investments to be certified under Section 231.103. Requires the comptroller, if a pending request cannot be fully certified due to this limit, to certify the portion that can be certified unless the qualified community development entity elects to withdraw the request rather than receive partial certification.

Sec. 231.105. TRANSFER OF INVESTMENT AUTHORITY. Authorizes an approved applicant to transfer all or a portion of its certified qualified equity investment authority to its controlling entity or to a qualified community development entity controlled by or under common control with the applicant, if the applicant provides the information required in the application with respect to the recipient of the transfer and notifies the comptroller of the transfer not later than the 30th day after the date of the transfer.

Sec. 231.106. ISSUANCE OF QUALIFIED EQUITY INVESTMENT. (a) Requires the qualified community development entity or a recipient of a transfer under Section 231.105, not later than the 60th day after the date the applicant receives notice of certification, to issue the qualified equity investment and receive cash in the amount certified.

(b) Requires the qualified community development entity or a recipient of a transfer under Section 231.105 to provide the comptroller with evidence of the receipt of the cash investment not later than the 10th business day after the date the cash investment is received.

Sec. 231.107. LAPSE OF CERTIFICATION. (a) Provides that, if the qualified community development entity or a recipient of a transfer under Section 231.105 does not receive the cash investment and issue the qualified equity investment before the 30th day after the date the certification notice is received as required by Section 231.106, the certification lapses and the qualified community development entity is prohibited from issuing the qualified equity investment without reapplying to the comptroller for certification.

(b) Requires the comptroller, if a certification lapses under this section, to reissue the certified amount, giving preference to an applicant whose allocation was reduced under Section 231.104. Requires the comptroller, if more than one applicant had its allocation reduced, to reissue the certified amount on a pro rata basis. Requires the comptroller, after the allocation to applicants whose allocation was reduced under Section 231.104, to reissue any certified amount that remains in accordance with the application process.

#### SUBCHAPTER D. RECAPTURE OF PREMIUM TAX CREDIT

Sec. 231.151. RECAPTURE. (a) Requires the comptroller, subject to Section 231.152, to recapture the amount of a tax credit claimed on a premium tax report filed under this subtitle from the qualified investor or a subsequent holder of the qualified equity investment that claims the credit if:

(1) any amount of a federal tax credit available with respect to a qualified equity investment that is eligible for a credit under this chapter is recaptured under Section 45D, Internal Revenue Code of 1986, in which case the comptroller's recapture is required to be proportionate to the federal recapture with respect to the qualified equity investment;

(2) the issuer redeems or makes principal repayment with respect to a qualified equity investment before the seventh anniversary of the date the qualified equity investment is issued, in which case the comptroller's recapture must be proportionate to the amount of the redemption or repayment with respect to the qualified equity investment;

(3) the issuer fails to invest an amount equal to 100 percent of the purchase price of the qualified equity investment in qualified low-income community investments in this state during the 12-month period immediately following the date the qualified equity investment is issued or to maintain at least 100 percent of that level of investment in qualified low-income community investments in this state until the last credit allowance date for the qualified equity investment; or

(4) at any time before the final credit allowance date of a qualified equity investment, the issuer uses the cash proceeds of the qualified equity investment to make qualified low-income community investments in any one qualified active low-income community business, including affiliated qualified active low-income community businesses, exclusive of reinvestments of capital returned or repaid with respect to earlier investments in the qualified active low-income community business and its affiliates, in excess of 25 percent of the cash proceeds of all qualified equity investments issued by the issuer under this chapter.

(b) Provides that, for purposes of this chapter, an investment is considered held by an issuer even if the investment has been sold or repaid if the issuer reinvests an amount equal to the capital returned to or recovered by the issuer from the original investment, exclusive of any profits realized, in another qualified low-income community investment not later than the 12th month after the date the issuer receives the capital.

(c) Provides that an issuer is not required to reinvest capital returned from a qualified low-income community investment after the sixth anniversary of the date the qualified equity investment is issued, the proceeds of which were used to make the qualified low-income community investment, and the qualified low-income community investment is considered held by the issuer through the seventh anniversary of the date the qualified equity investment was issued.

(d) Requires that periodic amounts received during a calendar year as repayment of principal on a loan that is a qualified low-income community investment be treated as continuously invested in a qualified low-income community investment if the amounts are reinvested in one or more qualified low-income community investments not later than the last day of the following calendar year.

Sec. 231.152. NOTICE OF NONCOMPLIANCE. (a) Requires the comptroller to notify a qualified community development entity and a qualified investor that has claimed a tax credit on a premium tax report if the credit is subject to recapture under Section 231.151.

(b) Prohibits the comptroller from recapturing a tax credit under this subchapter if the qualified community development entity cures the noncompliance described by Section 231.151 before the 180th day after the date the qualified community development entity receives notice under Subsection (a).

#### SUBCHAPTER E. PERFORMANCE DEPOSIT

Sec. 231.201. PERFORMANCE DEPOSIT OR SURETY BOND REQUIRED. (a) Requires a qualified community development entity that submits an application to have an equity investment or long-term debt security certified as a qualified equity investment eligible for premium tax credits under this chapter, except as provided by Subsection (c), to deposit \$500,000 with the comptroller for deposit in the new markets performance guarantee account, or maintain a surety bond of an equal amount.

(b) Requires the comptroller, if the comptroller denies an application described by Subsection (a) in full, to refund the deposit to the applicant not later than the 15th day after the date of the denial.

(c) Provides that a qualified community development entity is not required to make a deposit under this section if the qualified community development entity is formed or operated by a governmental entity or a nonprofit organization.

Sec. 231.202. FORFEITURE OF DEPOSIT. (a) Requires a qualified community development entity that makes a performance deposit under Section 231.201(a) to forfeit the deposit in its entirety if:

(1) the qualified community development entity and any qualified community development entity to which a transfer is made by the qualified community development entity under Section 231.105 fail to issue the total amount of qualified equity investments certified by the comptroller and receive cash in the total amount certified under Section 231.103 not later than the date specified by Section 231.106; or

(2) the qualified community development entity or a qualified community development entity to which a transfer is made by the qualified community development entity under Section 231.105 that issues a qualified equity investment certified under Section 231.103 fails to meet the investment requirement under Section 231.151(a)(3) by the second credit allowance date of the qualified equity investment.

(b) Requires the comptroller to notify a qualified community development entity that has made a deposit under Section 231.201(a) if the deposit is subject to forfeiture under this section.

(c) Provides that a deposit is not subject to forfeiture under Subsection (a)(2) if the qualified community development entity cures the noncompliance before the 180th day after the date the qualified community development entity receives notice under Subsection (b).

Sec. 231.203. NEW MARKETS PERFORMANCE GUARANTEE ACCOUNT. (a) Requires that the deposit required by Section 231.201(a) be made with the comptroller and held in the new markets performance guarantee account until the comptroller finds that the qualified community development entity has complied with the provisions of this chapter.

(b) Authorizes the qualified community development entity to request a refund of the deposit from the comptroller not earlier than the 30th day after the date the requirements that must be satisfied to avoid forfeiture of the deposit, as described by Section 231.202, are satisfied.

(c) Requires the comptroller to refund the deposit or, if applicable, give notice of noncompliance not later than the 30th day after the date of receiving a request that complies with Subsection (b).

#### SUBCHAPTER F. EVALUATION OF BUSINESS BY COMPTROLLER

Sec. 231.251. REQUEST FOR EVALUATION. (a) Authorizes a qualified community development entity to, before making an investment in a business, request a written opinion from the comptroller as to whether the business in which the qualified community development entity proposes to invest would qualify as a qualified active low-income community business according to Section 231.003.

(b) Requires the comptroller, not later than the 15th business day after the date of the receipt of a request under Subsection (a), to:

(1) determine whether the business meets the definition of a qualified active low-income community business, as applicable, and notify the

qualified community development entity of the determination and provide an explanation of the determination; or

(2) notify the qualified community development entity that the comptroller requires additional time, which is prohibited from exceeding 15 days, to review the request and make the determination.

(c) Provides that, if the comptroller fails to notify the qualified community development entity with respect to the proposed investment within the period as specified by Subsection (b), the business in which the qualified community development entity proposes to invest is considered to be a qualified active low-income community business.

Sec. 231.252. CONSIDERATION OF INTERNAL REVENUE CODE. Requires the comptroller, in issuing a written opinion and making other determinations under this chapter, to consider Section 45D, Internal Revenue Code of 1986, and the rules and regulations issued under that code, to the extent that those provisions are applicable.

#### SUBCHAPTER G. REPORTING

Sec. 231.301. REPORT TO COMPTROLLER. (a) Requires a qualified community development entity that issues a qualified equity investment under Section 231.106, except as provided by this subsection, to submit an annual report to the comptroller not later than the fifth business day after the anniversary of a credit allowance date applicable to the investment. Provides that the qualified community development entity is not required to submit any report under this section after the annual report following the final applicable credit allowance date.

(b) Requires that the report:

(1) provide evidence that the qualified community development entity has not failed to meet the investment requirement under Section 231.151(a)(3);

(2) include one or more bank statements for the qualified community development entity that reflect each qualified low-income community investment made by the qualified community development entity in connection with the qualified equity investment;

(3) state the name, location, and industry code of each qualified active low-income community business receiving a qualified low-income community investment in connection with the qualified equity investment and, if the qualified community development entity did not receive a written opinion under Section 231.251 with respect to a qualified active low-income community business, include evidence that the business was a qualified active low-income community business at the time the qualified low-income community investment was made;

(4) state the number of employment positions created and retained as a result of each qualified low-income community investment made in connection with the qualified equity investment;

(5) state whether the qualified community development entity has been subject to a recapture of any amount of a federal tax credit available under Section 45D, Internal Revenue Code of 1986, with respect to the qualified equity investment; and

(6) include a copy of the most recent annual report submitted by the qualified community development entity to the United States Department of the Treasury regarding Section 45D, Internal Revenue Code of 1986.

(c) Requires a qualified community development entity that fails to submit a report to the comptroller within the time prescribed by Subsection (a) to pay to the comptroller a penalty equal to \$25,000 plus \$5,000 for each day the report is not submitted after the date the report is due under Subsection (a).

Sec. 231.302. COMPTROLLER'S REPORT TO THE LEGISLATURE. (a) Requires the comptroller to contract with an independent researcher from an education research center established under Section 1.005 (Education Research Centers; Sharing Student Information), Education Code, to prepare a biennial report with respect to the implementation of this chapter.

(b) Requires that the report include:

(1) the number of qualified community development entities holding certified qualified equity investments;

(2) the amount of qualified equity investments of each qualified community development entity;

(3) the amount of qualified low-income community investments each qualified community development entity has invested in qualified active low-income community businesses as of the most recent annual report submitted to the comptroller by the qualified community development entity;

(4) the total amount of premium tax credits earned under this chapter;

(5) the performance of each qualified community development entity with respect to reporting requirements imposed by this chapter;

(6) with respect to each qualified active low-income community business in which a qualified community development entity has invested the classification of the qualified active low-income community business according to the industrial sector and the size of the business; the total number of jobs created by the qualified low-income community investment and the average wages paid for the jobs; and the total number of jobs retained as a result of the qualified low-income community investment and the average wages paid for the jobs; and

(7) an examination of the effect the implementation of this chapter has had on economic activity in this state and on state tax revenue during the biennium.

(c) Requires the comptroller to file the report with the governor, the lieutenant governor, and the speaker of the house of representatives not later than December 15 of each even-numbered year.

SECTION 2. (a) Requires the comptroller, as soon as practicable after the effective date of this Act, to adopt rules necessary to implement the provisions of Chapter 231, Insurance Code, as added by this Act, that apply to the comptroller.

(b) Requires the comptroller to accept applications for certification of qualified equity investments as required by Chapter 231, Insurance Code, as added by this Act, beginning not later than October 2, 2013.

SECTION 3. Effective date: September 1, 2013.