HOUSE
RESEARCH
ORGANIZATION bill analysis 4/15/2019

HB 1000 (2nd reading)
Paddie, et al.
(CSHB 1000 by Metcalf)

SUBJECT: Creating tax credits for investments in rural and opportunity funds

COMMITTEE: International Relations and Economic Development — committee substitute recommended

VOTE: 8 ayes — Anchia, Frullo, Blanco, Cain, Larson, Metcalf, Perez, Raney

0 nays

1 absent — Romero

WITNESSES: For — Jeff Craver, Advantage Capital; Mackenzie Ledet, Stonehenge Capital Company, Rural Jobs Coalition; (*Registered, but did not testify*: Lauren Spreen, Apache Corporation; Jimmy Carlile, Fasken Oil and Ranch, Ltd.; Annie Spilman, National Federation of Independent Business; James Hines, Texas Association of Business; Jamie Dudensing, Texas Association of Health Plans; Mike Meroney and Fred Shannon, Texas Association of Manufacturers; Carlton Schwab, Texas Economic Development Council; Michael Pacheco, Texas Farm Bureau; Shanna Igo, Texas Municipal League; Donnis Baggett, Texas Press Association; Jay Propes)

Against — Dick Lavine, Center for Public Policy Priorities; Jay Holtz

DIGEST: CSHB 1000 would create a tax credit program for investors who invested in rural and opportunity funds. The bill would establish a tax credit against an investor's state insurance tax liability, equal to a quarter of the investor's equity interest in the fund or long-term loans made to it.

The Texas Economic Development and Tourism Office (TEDTO) within the Office of the Governor would approve or deny investors' applications to participate in the program, and the comptroller would administer the program's tax aspects. Up to $35 million in tax credits per year could be claimed under the program, excluding any credits carried forward from a previous year.

An entity invested in a fund approved as a rural and opportunity fund would be eligible for a credit for a tax year if the entity held a tax credit certificate for the investment and the third, fourth, fifth, or sixth anniversary of the closing date of the fund had occurred during the tax year.

The tax credit could not exceed the investor's total state insurance tax liability in a tax year, but it could be carried forward to another tax year, or transferred to an affiliate of the investor.

Application and selection process. An entity seeking approval as a rural and opportunity fund would be required to send an application to TEDTO. Applications would have to include:

- the total investment authority sought by the applicant under the applicant's business plan;
- evidence that the applicant or applicant's affiliates had invested at least $100 million in nonpublic companies located in rural counties or small towns, as defined by the bill, or in qualified federal opportunity zones;
- evidence that at least one principal in a federally licensed rural or small business investment company was, and had been for at least four years, an officer or employee of the applicant or an affiliate of the applicant;
- a copy of the rural business investment company license or small business investment company license for the company at which the officer or employee had worked;
- an estimate of the number of jobs created and retained as a result of the applicant's growth investments;
- a business plan that included a tax revenue impact assessment prepared by a third-party independent economic forecasting firm following specific criteria;
- a signed affidavit from each committed investor stating the amount of credit-eligible capital contributions the investor committed to making; and
- a nonrefundable application fee of $5,000.

The bill would require the office to make a decision on each application within 30 days of receipt and in the order in which the applications were received. Applications received on the same day would be considered to have been received simultaneously.

TEDTO could deny an application if the applicant's business plan did not demonstrate that the plan's state and local tax revenue impacts would exceed the cumulative amount of tax credits issued to the applicant's investors or for certain other reasons.

An application also could be denied if less than 65 percent of the total investment authority sought under the business plan consisted of investments of entities subject to state insurance tax liability.

If the office denied an application, the applicant would have 15 days after the denial to provide additional information to the office in order to complete the application or cure any defects. The office would then have 30 days to review and reconsider the application.

Whenever TEDTO approved an application, the office would provide written notice of approval to the applicant, including the amount of the fund's investment authority, and a tax credit certificate to each investor whose affidavit was included in the application. The certificate would show the investor's credit-eligible capital contribution. This amount would be used to calculate the tax credit due to the investor, equal to 25 percent of the credit-eligible amount invested in the fund.

After receiving approval as a designated rural and opportunity fund, a fund would have 60 days in which to collect the credit-eligible contribution from each investor issued a tax credit certificate, as well as certain other permitted investments. The fund would then have to send documentation to the office that was sufficient to prove the fund had collected the required amounts.

10 percent or more would need to consist of equity investments

contributed directly or indirectly by affiliates of the fund, including employees, officers, and directors of those affiliates.

Duties. A rural and opportunity fund approved under the bill would be required to make equity investments or loans to targeted small businesses in Texas. The bill would define a targeted small business as a business that, prior to a fund's investment, had fewer than 250 employees and had its principal business operations in rural or opportunity zones.

The bill would give rural and opportunity funds the right to request a written opinion from TEDTO as to whether a business in which the fund proposed to invest qualified as a targeted small business. The office would be required to notify the fund of its determination within 15 days.

At least 60 percent of a fund's total investment authority would need to be invested by a deadline about two years from the date of the fund's approval. The entirety of a fund's investment authority would have to be invested on or before the third anniversary of the fund's closing date, and at least two-thirds of these investments would need to be in rural communities.

Investors' report. A rural and opportunity fund would be required to submit an annual report to TEDTO documenting the fund's investments, providing a bank statement, and detailing the names of businesses receiving an investment. The report also would include the number of jobs created and retained as a result of those investments, the average annual salary of the jobs created and retained as well as evidence of any other benefit to the state as a result of the jobs, and any other information TEDTO required.

Clawbacks. TEDTO would be required to revoke a tax credit certificate in connection with an investment in a rural and opportunity fund if the fund:

- failed to invest certain amounts in targeted small businesses by statutory deadlines;

- made a distribution or payout to investors that resulted in the fund having less than 100 percent of its investment authority invested or available for investment; or
- invested in a small business that itself was an investor directly or indirectly in the fund.

TEDTO would have to notify a rural and opportunity fund of the reasons for a pending revocation of a tax credit certificate, and the fund would have 90 days to correct any violation outlined in the notice.

When a fund's certificate was revoked, TEDTO would be required to notify the comptroller, who would be required to recapture the amount of credit claimed on a filed tax report for the entity. The bill would establish a process for determining how remaining investment authority would be awarded following revocation of a certificate.

Additionally, the bill would set penalties that a fund would have to pay to TEDTO if it made a distribution to the fund's equity holders without meeting certain job creation and job retention targets.

Exit from program. A rural and opportunity fund would be allowed to apply to exit the program after six years. TEDTO would not be allowed to unreasonably deny this application or to revoke a tax credit certificate after the fund's exit.

Office of the Governor's report. Before the regular session of the 90th Legislature, TEDTO would have to submit a report on the economic benefits of the rural and opportunity fund program to the Legislature. This report would detail assessments of various outcomes of the investments made under the program.

Other provisions. TEDTO could not accept new applications to participate in the program after January 1, 2022, unless it found that the total positive fiscal effects of the program, under metrics defined in the bill, exceeded the sum of all tax credit certificates issued.

The bill would require TEDTO and the comptroller to adopt rules necessary to implement the bill. TEDTO would be required to begin accepting fund applications by January 1, 2020.

The bill would take effect September 1, 2019.

SUPPORTERS SAY:

CSHB 1000 would stimulate investment in rural Texas and distressed urban communities where a lack of access to capital is a key constraint on economic growth, job retention, and job creation.

By encouraging capital flows and cooperation among insurance companies, local community banks, and small businesses, the bill would help to grow the economy and generate jobs.

The investment program established by the bill would be open only to federally licensed investors who had demonstrated experience in rural growth-focused investing. This qualification should yield strong results for Texas.

The bill contains transparency provisions, clawbacks, and penalties to ensure that funds that would be authorized by the created program invested in local businesses and met job creation and job retention targets. This would help rural and distressed communities to generate more tax revenue to make up for the tax credits awarded.

OPPONENTS SAY:

CSHB 1000 would create a tax credit program that would be costly and ineffective at creating jobs and economic development. The bill would not contain adequate clawbacks to ensure the funds' accountability for the promised jobs and other economic benefits.

Eligibility criteria for participation in the program would be so narrowly constructed as to limit the number of possible applicants, which could limit competition. Tax credits would be awarded on a first come, first served basis, rather than on the basis of evaluation criteria, which might not allow for the best applicants to be awarded investment authority.

The tax revenues that would be forfeited under the bill could be better used in other ways that would more directly help rural areas and other struggling communities. A quarter of lost revenue would come out of public school funding, which could affect public education.

NOTES: According to an estimate from the Legislative Budget Board, CSHB 1000 would have no impact on general revenue related funds in fiscal 2020, fiscal 2021, and fiscal 2022. The bill would be estimated to have a probable negative impact of $35 million in general revenue related funds in fiscal 2023 and fiscal 2024, including $8.8 million from the Foundation School program in each fiscal year.