

BILL ANALYSIS

Senate Research Center
86R7668 BEF-D

S.B. 826
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Business & Commerce
3/8/2019
As Filed

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Currently, rural Texas businesses are underserved in access to capital markets. Rural Texas is predominantly served by smaller independent banks that are vital parts of the communities they serve. Community bankers are often the first phone call made by small businesses in rural Texas when capital is needed to establish a new business, expand existing facilities, or to buy new equipment.

These banks were hit particularly hard by the federal Dodd-Frank Act, which was passed in 2010. The legislation, passed in response to the 2008 financial crisis, put rules in place for small banks that increased compliance costs and diminished the amount of capital they were allowed to handle, capital that was badly needed over the past decade in rural Texas. As a result, small business loans that provide necessary injections of capital in rural areas became harder to find.

H.B. 1000/S.B. 826 creates a new tool for local community banks and economic development corporations in rural Texas by creating a Rural and Opportunity Fund (ROF) administered by the Governor's Office of Economic Development. The ROF simply acts as a holding account where capital from investors is channeled into an account earmarked for investment in businesses in rural areas of Texas. Additionally, the businesses are selected by those with the capital. There is a \$5 million limit on a loan to a qualifying business, so they are designed for small businesses. The amount of tax credits that may be issued out is capped at \$35 million per year.

The bill calls for a third party assessment on the number of jobs that could be created by each project, the amount of taxes that could be generated, and the total economic development impact to the area around the business. If these metrics are not met, the governor's office has the ability to claw back the tax credits from the participating Rural Business Investment Corporations (RBIC) and Small Business Investment Corporations (SBIC).

As proposed, S.B. 826 amends current law relating to rural and opportunity funds and insurance tax credits for certain investments in those funds; imposes a monetary penalty and authorizes fees.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the Texas Economic Development and Tourism Office in SECTION 1 (Section 487A.008, Government Code) of this bill.

Rulemaking authority is expressly granted to comptroller of public accounts of the State of Texas in SECTION 2 (Section 232.0002, Insurance Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Subtitle F, Title 4, Government Code, by adding Chapter 487A, as follows:

CHAPTER 487A. RURAL AND OPPORTUNITY FUNDS

SUBCHAPTER A. GENERAL PROVISIONS

Sec. 487A.0001. GENERAL DEFINITIONS. Defines "closing date," "growth investment," "qualified area," and "rural and opportunity fund" and defines "office" to mean the Texas Economic Development and Tourism Office (office).

Sec. 487A.0002. DEFINITION: AFFILIATE: (a) Defines "affiliate."

(b) Provides that for purposes of Subsection (a) an entity is controlled by another entity if the controlling entity holds, directly or indirectly, the majority voting or ownership interest in the controlled entity or has control over the day-to-day operations of the controlled entity by contract or by law.

Sec. 487A.0003. DEFINITION: CREDIT-ELIGIBLE CAPITAL CONTRIBUTION. (a) Defines "credit-eligible capital contribution."

(b) Provides that an investment made by an entity qualifies as a credit-eligible capital contribution only if the entity making the investment receives in exchange for the investment an equity interest in the rural and opportunity fund or, at par value or premium, a debt instrument that has a maturity date of at least five years from the closing date and a repayment schedule that is no faster than level principal amortization over five years.

Sec. 487.0004. DEFINITION: INVESTMENT AUTHORITY. (a) Defines "investment authority."

(b) Requires at least 65 percent of a rural and opportunity fund's investment authority to consist of credit-eligible capital contributions.

Sec. 487.0005. DEFINITION: JOBS CREATED. (a) Defines "jobs created."

(b) Provides that the number of jobs created by a targeted small business is calculated each year by subtracting the number of employment positions in this state at the targeted small business at the time of the initial growth investment in the targeted small business from the monthly average of those employment positions for that year. Requires the number, if the number calculated under this subsection is less than zero, to be reported as zero.

(c) Provides that the monthly average of employment positions for a year is calculated by adding together the number of employment positions existing on the last day of each month of the year and dividing by 12.

Sec. 487A.0006. DEFINITION: JOBS RETAINED. (a) Defines "jobs retained."

(b) Provides that the number of jobs retained by a targeted small business is calculated each year based on the monthly average of employment positions for that year.

(c) Provides that the monthly average of employment positions for a year is calculated by adding together the number of employment positions existing on the last day of each month of the year and dividing by 12.

(d) Prohibits the reported number of jobs retained for a year from exceeding the number reported on the initial report under Section 487A.0155. Requires the rural and opportunity fund to reduce the number of jobs retained for a year if employment at the targeted small business drops below the number reported on the initial report.

Sec. 487A.0007. DEFINITION: TARGETED SMALL BUSINESS. (a) Defines "targeted small business" to mean a business that, at the time of the initial growth investment in the business:

(1) had fewer than 250 employees; and

(2) has its principal business operations located in one or more qualified areas in this state.

(b) Provides that for purposes of Subsection (a)(2) the principal business operations of a business are located at a place where at least 60 percent of the business's employees work or where employees who are paid at least 60 percent of the business's payroll work.

(c) Provides that an out-of-state business that agrees to relocate or hire new employees using the proceeds of a growth investment to establish principal business operations in a qualified area in this state qualifies as a targeted small business if the business satisfies the requirement of Subsection (a)(1) at the time of the initial growth investment in the business and Subsection (a)(2) not later than the 180th day after receiving the initial growth investment or a later date agreed to by the office.

Sec. 487A.0008. RULES. Requires the office to adopt rules necessary to implement this chapter.

SUBCHAPTER B. APPROVAL OF RURAL AND OPPORTUNITY FUNDS

Sec. 487A.0051. APPLICATION. (a) Requires the office to accept applications from entities seeking approval as rural and opportunity funds.

(b) Requires an application to include:

(1) the total investment authority sought by the applicant under the applicant's business plan;

(2) evidence sufficient to prove to the office's satisfaction that, as of the date the applicant submits the application:

(A) the applicant or affiliates of the applicant have invested at least \$100 million in nonpublic companies, each of which is located in a municipality with a population of less than 50,000 or a county with a population of less than 200,000, regardless of whether the municipality or county is located inside or outside this state; and

(B) at least one principal in a rural business investment company licensed under 7 U.S.C. Section 2009cc et seq. or a small business investment company licensed under 15 U.S.C. Section 681 is, and has been for at least four years, an officer or employee of the applicant or of an affiliate of the applicant on the date the application is submitted;

(3) a copy of the rural business investment company license or small business investment company license described by Subdivision (2)(B);

(4) an estimate of the number of jobs created and jobs retained as a result of the applicant's growth investments;

(5) a business plan that includes a revenue impact assessment that:

(A) projects state and local tax revenue to be generated by the applicant's proposed growth investments; and

(B) is prepared by a nationally recognized third party independent economic forecasting firm using a dynamic economic forecasting

model that analyzes the applicant's business plan for the 10-year period following the date the applicant submits the application;

(6) a signed affidavit from each committed investor stating the amount of credit-eligible capital contributions the investor commits to making; and

(7) a nonrefundable application fee of \$5,000.

Sec. 487A.0052. DECISION ON APPLICATION. (a) Requires the office to make a determination on each application not later than the 30th day after the date the office receives the application. Requires the office to make application determinations in the order in which applications are received and to consider applications received on the same day to be received simultaneously.

(b) Authorizes the office to approve investment authority under this chapter in amounts that would allow not more than \$35 million in tax credits to be claimed under Section 232.0053, Insurance Code, in any calendar year, excluding any credit carryforwards under Section 232.0054, Insurance Code.

(c) Requires the office, if a request for investment authority exceeds the limitation under Subsection (b), to reduce the investment authority and the credit-eligible capital contributions for that application as necessary to avoid exceeding the limit. Requires the office, if multiple applications received on the same day request a combined investment authority that exceeds the limit under Subsection (b), to proportionally reduce the investment authority and the credit-eligible capital contributions for those applications as necessary to avoid exceeding the limit. Prohibits the office from reducing an applicant's investment authority for any reason other than as authorized by this subsection.

Sec. 487A.0053. GROUNDS FOR DENIAL. Authorizes the office to deny an application under this subsection only if:

(1) the application is incomplete or the application fee is not paid in full;

(2) the applicant fails to satisfy the requirements of Section 487A.0051(b)(2);

(3) the revenue impact assessment submitted under Section 487.0051(b)(5) does not demonstrate that the applicant's business plan will result in a positive economic impact on combined state and local revenue during the 10-year period covered by the assessment that exceeds the cumulative amount of tax credits that would be issued to the applicant's investors under Chapter 232, Insurance Code, if the application were approved;

(4) the credit-eligible capital contributions described in affidavits submitted under Section 487A.0051(b)(6) do not equal at least 65 percent of the total amount of investment authority sought under the applicant's business plan; or

(5) the office has already approved the maximum amount of investment authority allowed under Section 487A.0052(b).

Sec. 487.0054. SUBMISSION OF ADDITIONAL INFORMATION FOLLOWING DENIAL. (a) Authorizes the applicant, if the office denies an application, to provide not later than the 15th day after the date the office provides notice of denial, additional information to the office to complete, clarify, or cure defects in the application identified by the office.

(b) Provides that if the applicant completes, clarifies, or cures the defects in its application during the period prescribed by Subsection (a), the application is considered complete as of the original submission date.

(c) Provides that if the applicant fails to complete, clarify, or cure the defects in its application during the period prescribed by Subsection (a), the application is finally denied. Requires an applicant who wishes to reapply to resubmit an application in full with a new submission date.

(d) Requires the office to review and reconsider an application described by Subsection (a) for which the applicant provides additional information not later than the 30th day after the date the applicant provides the information. Requires the office to consider that application before any pending applications submitted after the date that application was originally submitted.

(e) Provides that this section does not apply to an application denied as a result of the applicant's failure to submit with the application affidavits required by Section 487A.0051(b)(6).

Sec. 487.0055. APPROVAL BY OFFICE. Requires the office, on approval of an application, to provide written notice to the applicant of the applicant's approval as a rural and opportunity fund, including the amount of the fund's investment authority, and to provide a tax credit certificate to each investor whose affidavit was included in the application and include on the certificate the amount of the investor's credit-eligible capital contribution.

Sec. 487A.0056. DUTIES OF FUND FOLLOWING APPROVAL. (a) Requires a rural and opportunity fund to:

(1) not later than the 60th day after the date the fund receives the approval notice under Section 487A.0055:

(A) collect the credit-eligible capital contribution from each investor issued a tax credit certificate under Section 487A.0055; and

(B) subject to Subsection (b), collect one or more investments of cash that, when added to the contributions collected under Paragraph (A), equal the fund's investment authority; and

(2) not later than the 65th day after the date the fund receives the approval notice under Section 487A.0055, send the office documentation sufficient to prove that the fund has collected the amounts described in Subdivision (1).

(b) Requires at least 10 percent of the rural and opportunity fund's investment authority to consist of equity investments contributed directly or indirectly by affiliates of the fund, including employees, officers, and directors of those affiliates.

Sec. 487A.0057. LAPSE OF APPROVAL. (a) Provides that if a rural and opportunity fund fails to comply with the requirements of Section 487A.0056, the fund's approval lapse and the corresponding investment authority described by Section 487A.0056(a)(1) does not count toward the limit prescribed by Section 487A.0052(b).

(b) Requires the office to first award lapsed investment authority pro rata to each rural and opportunity fund whose requested investment authority was reduced under Section 487A.0052(c). Authorizes the rural and opportunity fund to allocate the investment authority awarded under this subsection to the fund's investors in

the fund's discretions. Authorizes the office to award any remaining investment authority to new applicants.

Sec. 487A.0058. DISPOSITION OF APPLICATION FEES. Provides that application fees submitted to the office under Section 487A.0051(b)(7) are required to be deposited to the credit of the general revenue fund and are authorized to be appropriated only to the office for the purpose of administering this chapter.

SUBCHAPTER C. REVOCATION OF TAX CREDIT CERTIFICATE

Sec. 487A.0101. GROUNDS FOR REVOCATION. (a) Requires the office to revoke a tax credit certificate issued under Subchapter B in connection with an investment in a rural and opportunity fund if, before the fund exits the program under Section 487A.0151, the fund:

(1) subject to Subsection (b), fails to invest at least 60 percent of the fund's investment authority in growth investments in this state on or before the second anniversary of the closing date and 100 percent of the fund's investment authority in growth investments in this state on or before the third anniversary of the closing date;

(2) subject to Subsection (c) and after making the investments necessary to avoid revocation under Subdivision (1), fails to maintain growth investments equal to 100 percent of the fund's investment authority until the sixth anniversary of the closing date;

(3) makes a distribution or payment that results in the fund having less than 100 percent of its investment authority invested in growth investments in this state or available for investment in growth investments and held in cash or marketable securities; or

(4) subject to Subsection (d), makes a growth investment in a targeted small business that directly or indirectly through an affiliate owns, has the right to acquire an ownership interest in, makes a loan to, or makes an investment in the fund, an affiliate of the fund, or an investor in the fund.

(b) Provides that for purposes of Subsection (a)(1):

(1) the amount of growth investments that a rural and opportunity fund is authorized to count with respect to a particular targeted small business, including any amount invested in an affiliate of the targeted small business, is prohibited from exceeding the greater of \$5 million or 20 percent of the fund's investment authority; and

(2) at least 85 percent of the required investments is required to be growth investments in targeted small businesses whose principal business operations are located in, or are relocated to, one or more rural communities as defined by Section 12.046 (Texas Rural Investment Fund), Agriculture Code.

(c) Provides that for purposes of Subsection (a)(2):

(1) the amount of growth investments that a rural and opportunity fund is authorized to count with respect to a particular targeted small business, including any amount invested in an affiliate of the targeted small business, is prohibited from exceeding the greater of \$5 million or 20 percent of the fund's investment authority;

(2) an investment that is sold or repaid is considered to be maintained if the rural and opportunity fund reinvests an amount equal to the capital

returned or recovered by the fund from the original investment, excluding any profit realized, in another growth investment in this state on or before the first anniversary of the date the capital is returned or recovered; and

(3) an amount received periodically by a rural and opportunity fund is considered to be continually invested in growth investments if that amount is reinvested in one or more growth investments by the end of the calendar year following the year of receipt.

(d) Provides that Subsection (a)(4) does not apply to investments in publicly traded securities by a targeted small business or an owner or affiliate of the targeted small business. Provides that a rural and opportunity fund, for purposes of Subsection (a)(4), is not considered an affiliate of a targeted small businesses solely as a result of the fund's growth investment in the targeted small business.

(e) Requires the office to notify the comptroller of public accounts of the State of Texas (comptroller) when the office revokes a tax credit certificate and, on request, to provide the comptroller with lists of valid and revoked tax credit certificates.

Sec. 487A.0102. OPPORTUNITY TO CORRECT VIOLATION. (a) Requires the office, before revoking a tax credit certificate under this subchapter, to notify the rural and opportunity fund of the reasons for the pending revocation.

(b) Authorizes the rural and opportunity fund to, not later than the 90th day after the date the notice is received, correct any violation outlined in the notice to the satisfaction of the office and avoid revocation of the tax credit certificate.

Sec. 487A.0103. ALLOCATION OF REVOKED INVESTMENT AUTHORITY. (a) Provides that, if a tax credit certificate is revoked under this subchapter, the associated investment authority does not count toward the limit on total investment authority described in Section 487A.0052(b).

(b) Requires the office to first award revoked investment authority pro rata to each rural and opportunity fund whose requested investment authority was reduced under Section 487A.0052(c). Authorizes the office to award any remaining investment authority to new applicants.

SUBCHAPTER D. CERTAIN FUND OPERATIONS

Sec. 487A.0151. APPLICATION TO EXIT PROGRAM. (a) Authorizes a rural and opportunity fund, on or after the sixth anniversary of the closing date, to apply to the office to exit the program and no longer be subject to regulation under this chapter.

(b) Requires the office to respond to the application not later than the 30th day after receipt.

(c) Provides that a rural and opportunity fund is eligible to exit the program under this section if no tax credit certificates related to investments in the fund have been revoked and the fund has not received any revocation notice that has not been corrected under Section 487A.0102.

(d) Prohibits the office from unreasonably denying an application under this section. Requires the office to give the rural and opportunity fund notice of a denial and include in the notice the reasons for the denial.

Sec. 487A.1052. NO REVOCATION FOLLOWING EXIT. Prohibits the office from revoking a tax credit certificate related to an investment in a rural and opportunity fund after the fund's exit from the program.

Sec. 487A.0153. PENALTY FOR CERTAIN DISTRIBUTIONS. (a) Defines "actual number of jobs created and retained" and "estimated number of jobs created and retained" for purposes of this section.

(b) Provides that a rural and opportunity fund is subject to a penalty in the amount provided by Subsection (c) if the fund authorizes a distribution to the fund's equity holders in an amount that, when added to all previous distributions to the fund's equity holders and any previous penalties under this section, exceeds the fund's investment authority and if the fund's actual number of jobs created and retained is less than the fund's estimated number of jobs created and retained.

(c) Provides that the amount of the penalty is equal to the amount of the authorized distribution multiplied by a fraction the numerator of which is the fund's estimated number of jobs created and retained less the fund's actual number of jobs created and retained and the denominator of which is the fund's estimated number jobs created and retained.

(d) Requires the fund, before making a distribution to the fund's equity holders, to deduct the amount of the penalty from the amount otherwise authorized to be distributed to the equity holders and to pay the penalty to the office.

(e) Requires the office to deposit penalties received under Subsection (d) in the general revenue fund.

Sec. 487A.0154. EVALUATION OF PROPOSED INVESTMENT. (a) Authorizes a rural and opportunity fund, before making a growth investment, to request from the office a written opinion as to whether the business in which the fund proposes to invest qualifies as a targeted small business.

(b) Requires the office, not later than the 15th business day after receiving the request, to notify the rural and opportunity fund of its determination.

(c) Provides that if the office fails to notify the rural and opportunity fund of its determination on or before the 15th business day after receiving the request, the business in which the fund proposes to invest is considered to be a targeted small business for purposes of this chapter.

Sec. 487A.0155. ANNUAL REPORT. (a) Requires a rural and opportunity fund to submit a report to the office on or before the fifth business day after each anniversary of the closing date until the fund has exited the program under Section 487A.0151.

(b) Requires the report to document the rural and opportunity fund's growth investments and include:

(1) a bank statement showing each growth investment;

(2) the name, location, and industry of each business receiving a growth investment, including either the determination notice described by Section 487A.0154 or evidence that the business qualified as a targeted small business at the time the investment was made;

(3) the number of jobs created and jobs retained in the preceding calendar year as a result of the fund's growth investments as of the last day of that period;

(4) the average annual salary of the jobs described by Subdivision (3); and

(5) an other information the office requires.

(c) Authorizes, but does not require, a rural and opportunity fund to include in any report submitted under this section information about the number of jobs created and jobs retained with respect to a former growth investment that the fund has exited.

SECTION 2. Amends Subtitle B, Title 3, Insurance Code, by adding Chapter 232, as follows:

CHAPTER 232. TAX CREDIT FOR INVESTMENT IN RURAL AND
OPPORTUNITY FUND

SUBCHAPTER A. GENERAL PROVISIONS

Sec. 232.001. DEFINITIONS. Defines "affiliate," "closing date," and "state insurance tax liability."

Sec. 232.0002. RULES. Requires the comptroller to adopt rules necessary to implement this chapter.

SUBCHAPTER B. TAX CREDIT

Sec. 232.0051. ELIGIBILITY FOR CREDIT. Provides that an entity is eligible for a credit against the entity's state insurance tax liability in the amount and under the conditions and limitations provided by this chapter.

Sec. 232.0052. QUALIFICATION. Provides that an entity is eligible for a credit for a tax year if the entity holds a tax credit certificate issued under Section 487A.0055, Government Code, and the third, fourth, fifth, or sixth anniversary of the closing date in connection with which the certificate was issued occurs during the tax year.

Sec. 232.0053. AMOUNT OF CREDIT; LIMITATION. (a) Provides that the amount of credit for a tax year is equal to 25 percent of the amount of the credit-eligible capital contribution stated on the tax credit certificate described by Section 232.0052.

(b) Prohibits the total credit claimed for a tax year, including the amount of any carryforward under Section 232.0054, from exceeding the amount of the state insurance tax liability due for the entity for the tax year after applying all other applicable tax credits.

(c) Authorizes credits to be applied to the entity's estimated or final tax payments for the tax year.

Sec. 232.0054. CARRYFORWARD. Authorizes an entity, if the entity is eligible for a credit that exceeds the limitation under Section 232.0053(b), to carry the unused credit forward for not more than 20 consecutive tax reports. Provides that credits, including credit carryforwards, are considered to be used in the following order:

(1) a credit carryforward under this subchapter; and

(2) a current year credit.

Sec. 232.0055. ASSIGNMENT PROHIBITED. (a) Prohibits an entity, except as provided by Subsection (b), from conveying, assigning, or transferring the credit allowed under this chapter to another entity.

(b) Authorizes an entity to convey, assign, or transfer the credit allowed under this chapter to an affiliate of the entity that is subject to state insurance tax liability.

Sec. 232.0056. RETALIATORY TAX. Provides that an entity claiming a 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.

SUBCHAPTER C. RECAPTURE OF CREDIT

Sec. 232.0101. RECAPTURE. Requires the comptroller to recapture the amount of a credit claimed on a tax report filed under Chapter 221 (Property and Casualty Insurance Premium Tax), 222 (Life, Health, and Accident Insurance Premium Tax), 223 (Title Insurance Premium Tax), 223A (Captive Insurance Premium Tax), 224 (Reciprocal and Interinsurance Exchange Premium Tax), 225 (Surplus Lines Insurance Premium Tax), 226 (Unauthorized and Independently Procured Insurance Premium Tax), or 281 from an entity if the tax credit certificate on which the credit is based is revoked under Subchapter C, Chapter 487A, Government Code.

SECTION 3. (a) Provides that as soon as practicable after this Act becomes law as provided by Section 2001.006 (Actions Preparatory to Implementation of Statute or Rule), Government Code:

(1) The office is required to adopt rules necessary to implement Chapter 487A, Government Code, as added by this Act; and

(2) the comptroller is required to adopt rules necessary to implement Chapter 232, Insurance Code, as added by this Act.

(b) Requires the office to begin accepting applications under Section 487A.0051(a), Government Code, as added by this Act, not later than January 1, 2020.

SECTION 4. Makes application of Chapter 232, Insurance Code, as added by this Act, prospective to January 1, 2020.

SECTION 5. Effective date: September 1, 2019.