SENATE BILL REPORT
E3SHB 1324

As of March 21, 2019

Title: An act relating to creating the Washington rural development and opportunity zone act.

Brief Description: Creating the Washington rural development and opportunity zone act.

Sponsors: House Committee on Appropriations (originally sponsored by Representatives Chapman, Maycumber, Springer, Chandler, Blake, Stokesbary, Steele, Reeves, Pettigrew, Dolan, Volz, Barkis, Eslick, Lekanoff, Tharinger, Hoff, Jinkins, Kilduff and Leavitt).

Brief History: Passed House: 3/07/19, 97-0.
Committee Activity: Financial Institutions, Economic Development & Trade: 3/19/19.

Brief Summary of Bill

- Creates the Rural Development and Distressed Opportunity Zone Program.
- Provides tax credits on the insurance premium tax or business and occupations (B&O) tax for contributions to a Rural Development and Distressed Opportunity Zone Fund.
- Extends a reduced B&O tax rate on certain timber-related activities.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, ECONOMIC DEVELOPMENT & TRADE

Staff: Kellee Gunn (786-7429)

Background: Rural and Small Business Investment Companies. Rural Business Investment Companies (RBIC) and Small Business Investment Companies (SBIC) are privately owned and managed investment funds, licensed and regulated by the United States Department of Agriculture (USDA) and the Small Business Administration (SBA), respectively. Both allow for capital investments in small businesses and smaller enterprises located in rural areas. Both RBICs and SBICs raise private capital from investors and may receive borrowed capital from the USDA or SBA, respectively, in order to fund the investments.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

An RBIC or SBIC program is a provision in a state or federal tax code that offers incentives for private capital to invest in small businesses, startups, low-income areas, or regions otherwise under economic distress. These programs often include special criteria for a certain quantity of the credit to focus on rural or underdeveloped areas.

Opportunity Zones. Opportunity zones were created through the federal Tax Cuts and Jobs Act, signed into law on December 22, 2017. The governor of every state may designate up to 25 percent of eligible census tracts as opportunity zones. To qualify as an opportunity zone, a census tract must have an individual poverty rate of at least 20 percent and median family income up to 80 percent of the area median. In April 2018, 139 census tracts became opportunity zones out of the 555 that qualified.

Business and Occupation Tax. Washington's major business tax is the B&O tax. The B&O tax is imposed on the gross receipts of all taxable business activities conducted within the state, unless otherwise exempt.

Insurance Premiums Tax. Washington State collects a net premium on authorized insurers, except title insurers and fraternal benefit societies. This includes:

- private insurers;
- health maintenance organizations;
- health care service contractors; and
- certain self-funded multiple employer welfare arrangements.

The tax rate in insurance premiums is 2 percent, except for ocean marine and foreign trade who pay 0.95 percent.

Business and Occupation Tax Rate on Timber Activities. On July 1, 2007, the B&O tax rate was reduced to 0.003424 for certain activities related to the timber industry including:

- standing timber sales;
- extracting or extracting for hire timber;
- manufacturing or processing for hire timber into timber, wood, or other products; and
- selling certain timber and wood products at wholesale.

The preferential rate is comprised of a base rate of 0.2904 percent plus a surcharge of 0.052 percent. This reduced B&O tax rate will expire June 30, 2024.

Summary of Bill: The Washington Rural Development and Distressed Opportunity Zone Act is established for the stated purpose of creating and retaining jobs in rural and distressed opportunity zone areas of Washington.

Eligible Areas. A person may contribute to a rural development and distressed opportunity zone fund (fund) for the purpose of creating and retaining jobs in qualified areas of Washington. A qualified area is either:

- a county with a population density of less than 100 persons per square mile or a county smaller than 225 square miles as determined by the Office of Financial Management (OFM); or
- a qualified opportunity zone as defined by the federal Tax Cuts and Jobs Act located in a distressed area.

The definition of distressed area includes rural counties, counties with an unemployment rate 20 percent above the state average for the last three years, counties with a median income less than 75 percent of the state median household income for the previous three years, or certain areas within a county with 5000 or more people with a certain level of unemployment and incomes below 80 percent of the county's median income for families and unrelated individuals.

According to 2018 population density data from OFM, at least 30 counties would qualify by population density. Certain areas within the other nine counties may be eligible if they meet the criteria for a distressed area within an opportunity zone.

<u>Application, Approval, and Allocations.</u> Beginning January 1, 2020, the Department of Commerce (Commerce) must accept applications for approval as a fund and approve them within 30 days of receipt. Commerce may not approve more than $100 million dollars in investment authority and not more than $60 million dollars in credit-eligible capital contributions.

Each applicant must pay a $5,000 application fee. The application must include certain information on the investment authority and include:

- a copy of their license as a RBIC or SBIC;
- an estimate of the number of jobs created and jobs retained in this state, certified by the business;
- a business plan that includes a revenue impact assessment over ten years, prepared by a firm that uses a dynamic economic forecasting model; and
- a signed affidavit from each investor stating the amount of credit-eligible capital contributions each taxpayer commits to make, and against which tax.

The applicant may receive credits from either their B&O tax, or the insurance premium tax. Applications may only be approved by RBICs and SBICs, or their affiliates, having at least $150 million in nonpublic companies located within or without Washington State, and at least one principal that has been an officer or employee for an RBIC or SBIC for at least four years.

Their investment authority is limited to $35 million and $21 million in credit-eligible capital contributions (contributions) unless fewer than three RBIC and SBICs, or both, are approved then the approved companies may apply for additional investment authority and capital contributions in excess of the limit.

<u>Denial of an Application.</u> An RBIC or SBIC application can only be denied for the following:

- the application is incomplete or application fee is not paid in full;
- criteria regarding the RBIC and SBIC, or both, is not satisfied;
- the business plan does not demonstrate a positive net impact over a ten-year period that exceeds the amount taken in tax credits;
- contributions do not equal at least 60 percent of the total amount of investment authority; or

- Commerce has already approved the maximum amount of investment authority and credit contributions.

Contributions to the Fund. After approval of the application, the fund has 60 days to collect the contributions and cash investments equal to the investment authority. An amount equal to at least 10 percent of the fund's investment authority must be equity investments by affiliates of the fund. The contributions into the fund must be a cash investment, which Commerce has verified and provided the investor with a tax credit certificate (certificate). The fund must reimburse Commerce for the cost of administering the program from application approval to exit, cased upon a formula relative to the investment authority.

The certificate indicates the fund is fully funded. Commerce must then provide copies of the certificate to the Office of the Insurance Commissioner and the Department of Revenue (DOR) for investors who are earning tax credits for either their insurance premiums taxes, or their B&O taxes. The certificate must include certain information regarding the amount invested, the investor, and the fund. Commerce must invoice the fund quarterly on its administration costs.

Up to one-third of the credit may be claimed for the fourth through sixth anniversaries of the closing date noted on the certificate, exclusive of amounts carried forward from prior years. The amount claimed for a tax reporting period may not exceed the amount of tax otherwise due and unused credits may be carried forward until used. No refunds may be granted for credits. Tax credits may only be transferred, or allocated, to an affiliate of the taxpayer, with verification from Commerce.

Each fund is required to report annually to Commerce on investments made until the fund exits the program.

Revoking a Certificate. A certificate must be revoked when the fund does not make certain contributions in growth investments, does not maintain the investment authority for six years, or makes certain investments in the same targeted small business. The fund has 90 days from notice by Commerce to correct any violation and avoid revocation of the certificate.

Exiting the Program. Before a fund may exit the program, Commerce must evaluate the number of jobs created and retained, and revenues generated pursuant or related to the program, to determine if the Fund must repay the state.

Jobs Created and Retained. The fund must only repay the state if:

- the amount of jobs created and retained is less than 60 percent of the amount filed on their application, then the fund must pay back 60 percent of the tax credits issued; and
- the amount of jobs created and retained is between 60 percent and 80 percent of the amount filed on their application, then the fund must repay the state 30 percent of the tax credits issued.

Any number at 80 percent or above the number of jobs estimated on a fund's application does not require repayment.

Revenues Generated. Over the course of the fund's participation in the program, if the aggregate state and local government revenues generated is less than the cumulative amount of tax credits issued, the fund must pay the state 100 percent of the difference. For calculating revenue, the fund may include investments in targeted small businesses as well as any additional investments made in those targeted small businesses in qualified areas using sources of capital not included within the Fund's investment authority.

<u>Tax Performance Statement on the Rural Development and Distressed Opportunity Zone Funds Program.</u> Within six years of the program, the Joint Legislative Audit Review Committee (JLARC) must review whether the program's tax credits led to job creation and retention and should be continued. JLARC may use the following data for their tax performance statement report:

- the annual report a taxpayer claiming the tax credit must file with DOR; and
- the annual reports required to be submitted by the funds.

<u>Timber B&O Tax and Surcharge Certain Wood Products.</u> The reduced B&O tax rate on certain activities related to the timber industry is changed from July 1, 2024, to July 1, 2036. The expiration for a surcharge imposed on certain timber and wood product manufacturers, extractors, and wholesalers is changed from July 1, 2024, to July 1, 2036. The extension of the reduced tax rate is exempted from the requirement to include a tax preference performance statement.

Appropriation: The bill contains a null and void clause requiring specific funding be provided in an omnibus appropriation act.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony: PRO: This bill passed off the House floor unanimously. My legislative district has high unemployment, and these rural areas have a difficulty raising capital. This is an opportunity to put $100 million in the most rural and distressed areas of the state. There is no risk to the state, and this legislation has claw back provisions if it does not perform. This revenue is not part of our budget outlook right now. Programs like this one have been around for decades; they began as CAPCO programs, then New Markets Tax Credit programs, and are now rural jobs programs. If we had dynamic fiscal notes, this legislation would not have a cost.

This has the strongest claw back provisions of any other program in the United States. These companies have skin in the game, and are required to have a 10 percent ownership. Through the program in Wyoming, jobs were created and there was access to capital that did not exist before. After some time, the Wyoming businesses were able to shift back to banks for funding. This has potential to bring investment into rural companies and lead to job growth. Section 9 of this bill incorporates claw back provisions to recapture investment. The state is investing in these businesses, and you want the requirements of these investment companies to be strong.

Back in 2006, the timber industry was looking for parity with the aerospace industry and a preferential B&O tax rate was created. The surcharge is used to fund participation grants. The preferential B&O tax rate, and the surcharge, should continue.

CON: This is an ineffective program. Over the recent legislative cycles, many states have passed bills like this one. These investment firms adjust the programs for whatever state legislators are willing to pass. The way this bill is written, only a few companies may take advantage of this program. No Washington-based firms would be eligible because none of them are federal RBICs or SBICs and being in one of those programs is a criterion for certification.

Recipients of these funds may not even be in Washington State as the legislation does not require a targeted small business, which is eligible to receive funding, to maintain its status during the entire time that the fund maintains its investment in that business. We agree with the intent of this bill, but this approach is fundamentally flawed. This is designed to support certain firms with bad track records of creating jobs. State auditors in states with programs like this have suggested to close the programs. This is not the Office of Financial Management who will be doing the economic analysis, but a private firm hired by the investment firms.

The extension of the timber tax will cost $135 million to the state. The state could use the $60 million in tax credits in the Rural Development and Distressed Opportunity Zone Act and instead invest it in Community and Technical Colleges, which would have a multiplier effect and would benefit at least 10,000 students.

OTHER: There is a mixed track record of these programs in other states. Considering the tax preference, what is the expectation of the jobs created per the state's investment? There is a need for small business loans, at low interest. When you think of opportunities to work on economic development, there are other options for investment including broadband or other infrastructure projects. There is a need for investment in rural areas.

We are in support of extending the preferential B&O tax rate for forest products and the surcharge on timber manufacturers that funds the adaptive management program at the Department of Natural Resources (DNR). The cap on the surcharge should be removed and revert to the language that was in previous versions that had been agreed to by the tribes, DNR, and the timber industry. Extending the surcharge will ensure the important work being done by the adaptive management program at DNR continues. The B&O reduction was originally tied with the surcharge, and they need to go forward together. The $8 million cap on the surcharge in Section 16 should be lifted to provide more funding for the adaptive management program and other grants. The federal funding provision should also be lifted. By lifting the federal funding condition, it would save the state money as there is still a requirement for the state to provide funding to the tribes for this purpose.

Persons Testifying: PRO: Representative Mike Chapman, Prime Sponsor; Trent House, Washington Bankers Association; Mike Ennis, Association of Washington Business; Steve Gano, Advantage Capital; Jennifer Ziegler, Washington Economic Development Association; Bill Stauffacher, Enhanced Capital; John Ehrenreich, Washington Forest Protection

Association; Daryl Williams, Tulalips Tribes.

CON: Andy Nicholas, Washington State Budget and Policy Center; John Burbank, Economic Opportunity Institute; Erin Haick, SEIU 925; Darrell Johnson, citizen; Julia Sass-Rubin, Rutgers University.

OTHER: Jasmine Vasavada, Department of Commerce; Joanna Eide, Department of Natural Resources; Jim Peters, Northwest Indian Fisheries Commission.

Persons Signed In To Testify But Not Testifying: No one.