

SUBJECT: Creating insurance tax credits for small business recovery fund investors

COMMITTEE: International Relations and Economic Development — committee
substitute recommended

VOTE: 6 ayes — Button, C. Morales, Beckley, C. Bell, Metcalf, Ordaz Perez

0 nays

3 absent — Canales, Hunter, Larson

WITNESSES: For — Ryan Dressler, Advantage Capital; Stephen Bennett, Stonehenge Capital; (*Registered, but did not testify:* Jay Propes, Advantage, Enhanced, and Stonehenge Capital Corporations; Christine Wright, City of San Antonio; Annie Spilman, NFIB; Jeremy Fuchs, Texas and Southwestern Cattle Raisers Association; J.D. Hale, Texas Association of Builders; Chris Noonan, Texas Chemical Council; Carlton Schwab, Texas Economic Development Council; Charlie Leal, Texas Farm Bureau; Monty Wynn, Texas Municipal League; Julia Parenteau, Texas Realtors)

Against — (*Registered, but did not testify:* Dick Lavine)

DIGEST: CSHB 570 would create an insurance tax credit for investors in an entity that was approved as a small business recovery fund by the Texas Economic Development and Tourism Office (TEDTO).

Tax credit. An entity would be eligible for a credit against its state insurance tax liability if the entity held a tax credit certificate issued by TEDTO in a year in which the third, fourth, fifth, or sixth anniversary of the closing date on which a small business recovery fund collected investments occurred.

The amount of credit would be equal to 25 percent of the amount of the credit-eligible capital contribution stated on the certificate.

If an entity was eligible for a credit that exceeded the amount of state

insurance tax liability due, the entity could carry the unused credit forward and apply the credit to a subsequent tax report.

An entity could not convey, assign, or transfer the credit to another entity, except to an affiliate that was subject to state insurance tax liability. An entity claiming a credit would not be required to pay any additional retaliatory tax levied as a result of claiming the credit.

The bill would require the comptroller to recapture the amount of a credit claimed on a tax report from an entity if the tax credit certification was revoked.

Application. TEDTO would have to accept applications from entities seeking approval as small business recovery funds. Applications would have to include:

- the total investment authority sought;
- evidence to prove that the applicant or its affiliate had invested at least \$100 million in nonpublic companies;
- evidence to prove that at least one principal in a licensed rural business investment company or a licensed small business investment company was, and had been for at least four years, an officer or employee of the applicant or an affiliate, and a copy of the company's license;
- an estimate of the number of jobs created and jobs retained that would result from the applicant's growth investments;
- a business plan including a revenue impact assessment;
- a signed affidavit from each committed investor stating the credit-eligible capital contributions the investor committed to making;
- and
- a nonrefundable application fee of \$5,000.

"Jobs created" and "jobs retained" would include employment positions that were created by a targeted small business or that would have been lost if a growth investment in such a business had not been made, were located in state, and required at least 35 hours of work each week. The bill would

detail how to calculate the number of jobs created and retained.

"Targeted small business" would mean a business that at the time of the initial growth investment had fewer than 250 employees and had its principal business operations in the state. For purposes of the bill, the principal operations of a business would be located at a place where at least 80 percent of the employees worked or where employees who were paid at least 80 percent of the payroll worked.

An out-of-state business that agreed to relocate or hire new employees using the proceeds of a growth investment to establish principal operations in the state would qualify as a targeted small business if it moved operations no later than 180 days after receiving the initial investment or a later date agreed to by TEDTO.

The application fee would be deposited to the general revenue fund and could be appropriated only to TEDTO for the purpose of administering the provisions of this bill.

TEDTO would have to make a determination on each application within 30 days of receiving the application, and determinations would have to be made in the order they were received.

TEDTO could approve up to \$500 million of investment authority in a calendar year. If a request or multiple simultaneous requests for investment authority exceeded that limit, TEDTO would have to reduce the investment authority and credit-eligible capital contributions for that application as necessary to avoid exceeding the limit. TEDTO could not reduce an applicant's investment authority for any other reason.

Denial of application. TEDTO could deny an application only if:

- the application was incomplete or the application fee was not paid in full;
- the application did not satisfy requirements of the bill;
- the revenue impact statement did not demonstrate that the

applicant's business plan would result in increased state and local revenue that exceeded the amount of tax credits that would be issued;

- the credit-eligible capital contributions did not equal at least 65 percent of the total amount of investment authority sought; or
- TEDTO had already approved the maximum amount of investment authority allowed.

Within 15 days of a denial, the applicant could provide additional information to TEDTO to complete, clarify, or cure defects in the application. If the defects were cured, the application would be considered complete as of the original submission date. This provision would not apply to an application denied due to the failure to submit affidavits.

Approval of application. On approval of an application, TEDTO would have to provide written notice of the applicant's approval as a small business recovery fund, including the amount of investment authority, and a tax credit certificate to each investor.

Within 60 days of approval, a small business recovery fund would have to collect the credit-eligible capital contribution from each investor and one or more investments of cash that when combined equaled the fund's investment authority. Within 65 days of approval, the fund would have to send to TEDTO documentation sufficient to prove the funds were collected.

At least 10 percent of the fund's investment authority would have to consist of equity investments contributed by affiliates of the fund, including employees, officers, and directors of those affiliates.

If a small business recovery fund failed to comply with these requirements, the fund's approval would lapse and the corresponding investment authority would not count toward the \$500 million limit.

TEDTO could not accept applications after January 1, 2022, unless the total positive fiscal effects exceeded the sum of all tax credit certificates

issued. The office would resume accepting applications when that condition was met.

Revocation of tax credit. TEDTO would have to revoke a tax credit certificate in connection with an investment in a small business recovery fund if the fund:

- failed to invest at least 60 percent of its investment authority in growth investments in the state by the second anniversary of the closing date and 100 percent of its investment authority by the third anniversary;
- failed to maintain growth investments equal to 100 percent of its investment authority until the sixth anniversary of the closing date;
- made a distribution or payment that resulted in the fund having less than 100 percent of its investment authority invested in growth investments or available and held in a certain manner; or
- made a growth investment in a targeted small business that owned, had the right to acquire ownership or interest in, made a loan to, or made an investment in the fund, an affiliate, or an investor.

The amount of investment authority that a fund could count towards growth investments with respect to a particular targeted small business could not exceed \$5 million. At least 75 percent of the required amounts of growth investments would have to be in targeted small businesses whose principal operations were located in a rural area.

An investment that was sold or repaid would be considered to be maintained if the fund reinvested an equal amount in another growth investment within a year of the date the capital was returned or recovered. An amount received periodically by a fund would be considered to be continually invested in growth investments if that amount was reinvested in growth investments by the end of the calendar year.

Revocation of a certificate for a fund that made an investment in a business that owned, made a loan to, or invested in the fund, an affiliate, or an investor would not apply to investments in publicly traded securities.

A fund would not be considered an affiliate of a targeted small business solely as a result of the fund's growth investment in the business.

Before revoking a certificate, TEDTO would have to notify the fund of the reasons for the pending revocation and the fund could, within 90 days, correct any violation and avoid revocation.

Exiting the program. On or after the sixth anniversary of the closing date, a small business recovery fund could apply to TEDTO to exit the program. A fund would be eligible to exit if no tax credit certifications were revoked and the fund had not received any revocation notice that had not been corrected.

TEDTO could not unreasonably deny an application to exit and would have to give the fund notice of a denial that included its reasoning. The office could not revoke a certificate related to an investment in a fund after it exited the program.

Penalty. A small business recovery fund would be subject to a penalty if the fund authorized a distribution to its equity holders in an amount that exceeded its investment authority and the fund's actual number of jobs created and retained was less than estimated. The penalty would be proportional to the number of jobs that were incorrectly estimated.

Before making a distribution to the equity holders, the fund would have to deduct the penalty and pay it to TEDTO, which would deposit the penalties in the general revenue fund.

Evaluation of proposed investment. A small business recovery fund could request from TEDTO an opinion as to whether a business in which the fund proposed to invest would qualify as a targeted small business. If TEDTO failed to notify the fund of its determination within 15 business days, the business would be considered a targeted small business.

Reporting. The bill would require a small business recovery fund to submit a report to TEDTO within 5 business days of each anniversary of

the closing date until the fund exited the program. The report would have to document the fund's growth investments and include certain other information as listed in the bill.

TEDTO would have to submit a report on the economic benefits of this program to the lieutenant governor, House speaker, and Legislature before the beginning of the 90th Legislature. The bill would detail the assessments the report would have to include. The report could not include information that was confidential by law.

Dates. As soon as practicable after the bill's effective date, TEDTO and the comptroller would have to adopt rules to implement the bill. TEDTO would have to start accepting applications by October 1, 2021.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2021. The bill would apply only to a tax report originally due on or after January 1, 2021.

**SUPPORTERS
SAY:**

CSHB 570 would create a targeted, pragmatic, market-driven incentive program to help Texas small businesses gain access to needed capital. The program would promote the partnership of experienced investors and local banks to increase economic development, especially in rural areas, generate jobs, and help struggling businesses affected by the COVID-19 pandemic. Such a program is critical to the state maintaining its competitive advantage and pays for itself with increased tax revenues.

Rural small businesses make up nearly a quarter of all employers in the state, though many lack the access to capital that more urban areas enjoy, restricting the financing options for such businesses. Additionally, uncertain economic outlooks have shied away investors, further reducing the available capital. By creating a program to incentivize investments in small business funds, which would invest in targeted small businesses, CSHB 570 would help bridge this gap in capital and foster economic development in rural communities. The majority of the fund would have to be invested in capital needy areas within two years and would have to

remain invested for several years, ensuring ongoing benefits.

The bill would protect taxpayers' interests by including strict credit clawback and transparency provisions. Small business recovery funds would have to report information on investments and their benefits, including the number of jobs created and retained, annually to the Texas Economic Development and Tourism Office. The bill also would require funds to pay a penalty back to the state for failure to create and retain the estimated number of jobs. Investors could only utilize tax credits three years after the closing date and only if the fund had met all requirements.

CRITICS
SAY:

CSHB 570 could cost state resources to the benefit of a few large established funds. It would authorize up to \$500 million a year in insurance tax credits for investors in certain small business funds. While the intent of this and similar programs is to receive an indirect return on a state's investment from tax revenue generated by new economic activity, this outcome has not panned out in this or other states.

The program would lack strong safeguards to ensure jobs were created or retained, and the bill largely would restrict denial of an application for the program. There would not be specific targets for the number of jobs recipients had to create nor wages the jobs would pay. Clawback provisions would apply where excess profits were distributed to investors but not where investment failed to provide adequate state benefits. Not all investments would have to go directly to eligible businesses. The bill would not have enough auditing or transparency measures and would not be subject to sunset or have enough review or reporting requirements. The tax credits could be carried forward indefinitely. Rather than spending \$125 million a year for this program, the state should work to aid small businesses through existing federal and state programs.

NOTES:

According to the Legislative Budget Board, the bill would cost \$794,936 in general revenue related funds in fiscal 2022-23 and \$125 million in fiscal 2024-25.