



# Ohio Legislative Service Commission

## Bill Analysis

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### H.B. 511

129th General Assembly  
(As Introduced)

**Reps.** Beck and Gonzales

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## BILL SUMMARY

- Terminates the Industrial Technology and Enterprise Advisory Council, which was created to approve tax credits for investments in development and technology transfer companies and to make recommendations for the award of other development assistance.
- Transfers duties of the Industrial Technology and Enterprise Advisory Council to the Third Frontier Commission.
- Eliminates the involvement of Edison Centers in reviewing applications for, and making recommendations regarding, those investment tax credits and substitutes the Director of Development for that role.
- Increases, from \$45 million to \$51 million, the maximum amount of investment tax credits that can be issued.
- Increases the annual limit on venture capital loan loss tax credits available to lenders to the state's venture capital loan program that lose money, and the amount of principal and interest payments that may be paid to lenders each year.
- Relaxes limits on the extent to which the program's investments may be concentrated in two or more venture capital funds that are under common management.
- Requires the selection criteria for investment funds to qualify to administer the program to include similar experience and a history of positive investment returns.

- Requires agreements for administering the program to specify that the investment fund administering the program and any fund managers employed by the administrator to have a "significant presence" in Ohio as defined in the agreement.
- Conforms Ohio New Markets Tax Credit to federal law, expands the class of credit-eligible businesses, and adjusts the amount of credit that may be claimed each year.

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## **CONTENT AND OPERATION**

### **Industrial Technology and Enterprise Advisory Council; investment tax credits and other technology and enterprise development assistance**

The bill terminates the Industrial Technology Enterprise Advisory Council effective October 1, 2012. The Council was created to do the following:

(1) Assist the Director of Development by reviewing applications for and making recommendations regarding the award of assistance under the Industrial Technology and Enterprise Development Grant Program, the Industrial Technology and Enterprise Resources Program, and the Thomas Alva Edison Grant Program. Under the bill, the Third Frontier Commission is to take over those duties.

(2) Receive recommendations from an Edison Center and make final determinations regarding the approval of tax credits for investments made in Ohio businesses that primarily involve research and development, technology transfer, biotechnology, or information technology. Under the bill, the Director, rather than an Edison Center, is to receive the applications for investment tax credits and make recommendations to the Third Frontier Commission. The Commission is given the responsibility of making the final determination as to the award of the tax credits.<sup>1</sup>

Further, the bill increases – from \$45 million to \$51 million – the maximum amount of investment tax credits that can be issued, and permits the Director to take up to four weeks to review initial tax credit applications, instead of the three weeks provided in current law.<sup>2</sup>

### **Venture capital loan loss tax credits**

The existing venture capital loan loss tax credit program permits financial institutions, insurance companies, dealers in intangibles, natural gas companies, and other companies and individuals to lend money to the program for investment by the

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<sup>1</sup> R.C. 121.22, 122.15 to 122.154, 122.29 (repealed), 122.30, 122.31, 122.36, and 184.02; Section 4.

<sup>2</sup> R.C. 122.151(A) and (D)(2).

program administrator(s) in venture capital funds and to have some or all of any losses they incur on the invested money to be compensated by a refundable tax credit against the applicable state tax. (Certain trust companies may claim the credit even if they are not subject to one of the state taxes.) The program is governed by the Ohio Venture Capital Authority, which prescribes the program's investment policies (subject to statutory restrictions), selects not more than two private investment funds to administer the program (currently only one investment fund has been selected to administer), and issues tax credits. The total amount of credits that currently may be issued under the program over its life is limited to \$380 million.<sup>3</sup>

The bill modifies the existing venture capital loan loss tax credit program in four respects.

The bill increases the annual tax credit limit from \$20 million to \$26.5 million. It also increases the amount of principal and interest payments that may be paid to taxpayers lending money to the investment fund from \$20 million to \$26.5 million. The bill does not change the existing all-year tax credit limit of \$380 million.<sup>4</sup>

The bill relaxes limits on the extent to which the program's investments may be concentrated in two or more venture capital funds that are under common management by applying those limits only to commonly managed funds that have been formed within two years of each other. Accordingly, if two funds have been formed more than two years apart, the concentration limits do not apply, even if the funds are under common management. The current concentration limits prohibit the program from investing more than the lesser of the following in a single venture capital fund or in two or more venture capital funds under common management: (1) \$10 million, or (2) a certain percentage of a venture capital fund's total capital from all investors (the percentage is 50% for Ohio-based venture capital funds, and 20% for non-Ohio-based funds).<sup>5</sup>

The bill requires that, when the Ohio Venture Capital Authority solicits requests for proposals from private investment funds to administer the program, the request's description of the evaluation criteria must specifically include the investment fund's past performance "in successfully administering similar programs and achieving

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<sup>3</sup> R.C. Chapter 150.

<sup>4</sup> R.C. 150.05(B) and 150.07.

<sup>5</sup> R.C. 150.03.

positive investment returns" (among the various other items currently required to be included in the request).<sup>6</sup>

Finally, the bill specifies that the agreement between the OVCA and a program administrator governing the program administrator's administration of the program must require the program administrator, and any fund manager employed by the administrator, to have a "significant presence" in Ohio, and must define how that is to be determined.<sup>7</sup> Currently, a program administrator must have "an established business presence" in Ohio, which is not defined.

### **Ohio New Markets Tax Credit**

Continuing law authorizes a nonrefundable tax credit with a four-year carryforward against the insurance and financial institution franchise taxes for insurance companies and financial institutions that purchase and hold securities issued by low-income community organizations to finance investments in qualified active low-income community businesses in Ohio, in accordance with the federal New Markets Tax Credit law.

### **Federal credit**

Federal law provides a credit against the federal income tax, totaling 39% of the cost of the investment at original issue, for making qualified equity investments in investment vehicles known as Community Development Entities (CDEs). A CDE is a United States corporation or partnership with the primary mission of serving or providing investment capital for businesses in low-income communities, that maintains accountability to residents of low-income communities through representation by them on the CDE's governing board or an advisory board, and that is certified as a CDE by the Secretary of the Treasury.

A qualified equity investment is the purchase of capital stock or capital interest in a partnership. The credit provided to the investor is applied over a seven-year period. Substantially all of the taxpayer's investment must in turn be used by the CDE to make qualified investments in "low-income communities."<sup>8</sup>

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<sup>6</sup> R.C. 150.05(A).

<sup>7</sup> R.C. 150.05(B)(10).

<sup>8</sup> 26 U.S.C. 45D (2012).

## Ohio credit

The current Ohio New Markets Tax Credit totals 39% of the "adjusted purchase price" of qualified equity investments in CDEs that use substantially all of the proceeds to make investments in qualified active low-income community businesses. To obtain the Ohio credit, a person must have qualified for the federal credit by holding a qualified equity investment. Under the Federal program, a CDE can make qualified investments in any state. For purposes of the Ohio credit, the "adjusted purchase price" of qualified investments is the percentage of those investments that are made in businesses located in Ohio. A qualified equity investment is an equity investment in a qualified CDE. An investor eligible to receive tax credits for its investment in a qualified CDE must be an insurance company subject to the state's insurance company franchise taxes or a financial institution subject to the state's corporation franchise tax. To be a qualified equity investment, the equity investment must be acquired after October 16, 2009, for cash, and at least 85% of the purchase price must be used by the issuer to make qualified low-income community investments. The investment may be transferred, so long as the transferee's holding would qualify if the transferee were the purchaser at the original issuance.

Credits must be applied over a seven-year period, beginning on the date a qualified equity investment is made and continuing for the next six anniversary dates.

Under continuing law, the amount of the credit that an insurance company or financial institution holding a qualified equity investment may claim is equal to 39% of the adjusted purchase price of qualified low-income community investments. Under current law, the amount of qualified low-income community investments is the total amount of investments that are invested in qualified low-income community businesses, up to \$2,564,000 in a fiscal year. A "qualified active low-income community business" is any partnership or corporation that derives less than 15% of its annual revenue from the rental or sale of real property (except for certain special purpose entities owned by the business and created for the purpose of renting or selling the property back to the tenant) and that, for any tax year, satisfies all of the following:

(1) At least 50% of total gross income of the entity is derived from the active conduct of qualified business within a low-income community;

(2) A substantial portion of the use of the tangible property of the entity (whether owned or leased) is within a low-income community;

(3) A substantial portion of the services performed for the entity by its employees are performed in a low-income community;

(4) Less than 5% of the average of the aggregate unadjusted bases of the property of the entity is attributable to collectibles (other than collectibles held primarily for sale in the ordinary course of business);

(5) Less than 5% of the average of the aggregate unadjusted bases of the property of the entity is attributable to nonqualified financial property.<sup>9</sup>

### **Credit allowance dates**

The bill accelerates an investor's receipt of credit installments by permitting credits of 5% of qualified equity investments in CDEs for the first three years and 6% for the final four years, compared with the current schedule of 0% in the first two years, 7% in the third year, and 8% in the final four years.<sup>10</sup> The amended credit allocation is the same credit allocation used in figuring the federal New Markets Tax Credit.<sup>11</sup>

### **Credit-eligible businesses**

The bill allows a CDE to make credit-eligible investments in a low-income community business that derives 15% or more of its annual revenue from renting or selling real estate.<sup>12</sup> Under current law, investments in such businesses would not be counted towards the required investment that would allow an investor to be eligible to claim the Ohio credit. The CDE is required to invest at least 85% of the investment in such businesses and at least 75% in the seventh year.

### **Designation of qualifying equity investments**

Under current law, a qualified CDE is required to designate equity investments it holds as qualified equity investments for the purpose of qualifying for the federal and Ohio New Markets Tax Credit. The bill permits CDEs to designate as a qualifying equity investment those investments committed from any CDE.<sup>13</sup>

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<sup>9</sup> 26 U.S.C. 45D (2012). Nonqualified financial property is financial property (debt, stock, partnership interests, options, futures contracts, forward contracts, warrants, notional principal contracts, annuities, and other similar property) that is not working capital held in cash, cash equivalents, or debt instruments with a term of 18 months or less; or accounts or notes receivable acquired in the ordinary course of business for services rendered, or from the sale of stock or inventory in the taxpayer's ordinary course of business.

<sup>10</sup> R.C. 5725.33(A).

<sup>11</sup> 26 U.S.C. 45D.

<sup>12</sup> R.C. 5725.33(A).

<sup>13</sup> R.C. 5725.33(A)(3).

### **Individual credit limit**

Under current law, the maximum allowable credit for each investor is equal to 39% of the maximum qualified equity investment amount of \$2,564,000 per fiscal year, or exactly \$999,960 per investor. The bill raises the amount of qualified equity investment allowed per investor to \$2,564,103, raising the maximum credit amount to \$1 million.<sup>14</sup>

### **Adjusted purchase price**

The bill eliminates the requirement that the "adjusted purchase price" of investments be calculated in determining the amount of the credit. However, the bill continues to base the credit on the amount invested in projects located in Ohio.<sup>15</sup>

### **Conform to federal law**

Under current law, any term not otherwise defined or limited by state law has the meaning as defined under federal New Markets Tax Credit law as that law existed on October 16, 2009, the effective date of Am. Sub. H.B. 1 of the 128th General Assembly. The bill conforms Ohio's New Markets Tax Credit law to reflect any changes made to those terms in federal law between October 16, 2009, and the effective date.<sup>16</sup>

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## **HISTORY**

<b>ACTION</b>	<b>DATE</b>
Introduced	04-12-12

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<sup>14</sup> R.C. 5725.33(B)(2).

<sup>15</sup> R.C. 5725.33(A) and (B).

<sup>16</sup> R.C. 5725.33(A).