

BILL ANALYSIS

C.S.H.B. 1718

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International Relations & Economic Development
Committee Report (Substituted)

BACKGROUND AND PURPOSE

Rural counties face continued underinvestment in local businesses despite over half of the state's 254 counties being classified as rural. According to data analyzed by the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, Texas ranks in the top three states with respect to the number of underserved or distressed census tracts. The PitchBook financial database shows that Texas' rural businesses receive only two to three, less than one percent, of the 400 average annual private equity and venture capital investments across the state. Rural businesses are particularly vulnerable as interest rates rise, lending standards tighten, and consumer prices grow on the heels of the COVID-19 pandemic. An infusion of capital investment in rural communities could be a catalyst for driving rural growth and economic competitiveness. C.S.H.B. 1718 seeks to address these concerns by providing for a public-private investment program designed exclusively for rural small businesses and an annual insurance premium tax credit for applicable investors.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the comptroller of public accounts in SECTIONS 1 and 2 of this bill.

ANALYSIS

C.S.H.B. 1718 amends the Government Code to provide for approval of rural development funds by the comptroller of public accounts for the provision of certain financing to targeted small businesses and amends the Insurance Code to create tax credits against state insurance liability for applicable investors in those funds.

For purposes of the bill's provisions regarding both the rural development funds and the tax credits, "targeted small business" means a business that, at the time of the initial growth investment in the business, had fewer than 250 employees and has its principal business operations located in Texas. With respect to the bill's provisions regarding the rural development funds, the bill specifies what constitutes a business's place of principal business operations and sets out circumstances under which 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 Texas may qualify as a targeted small business.

Rural Development Fund Approval

C.S.H.B. 1718 requires the comptroller to accept applications from entities seeking approval as rural development funds. The bill requires an application to include the following:

- the total investment authority sought by the applicant under the applicant's business plan;
- evidence sufficient to prove the following to the comptroller's satisfaction, as of the date the applicant submits the application:
 - that investments in nonpublic companies located in the United States by the applicant or its affiliates meet a \$100 million threshold, including at least \$70 million in nonpublic companies located in rural areas in the United States; and
 - that at least one principal of a federally licensed rural business investment company or small business investment company is, and has been for at least four years, an officer or employee of the applicant or an affiliate or the applicant or an affiliate has maintained its principal business operations in Texas for at least four years preceding September 1, 2023;
- a copy of the relevant federal license if required;
- an estimate of the number of jobs created and jobs retained that will result from the applicant's growth investments in targeted small businesses;
- a business plan that includes a certain revenue impact assessment;
- a signed affidavit from each committed investor stating the amount of credit-eligible capital contributions the investor commits to making; and
- a nonrefundable application fee of \$5,000.

The bill prescribes the manner of determining the number of jobs created and jobs retained and specifies that, for purposes of the calculation of the number of jobs created with respect to a targeted small business, an employment position that otherwise meets the eligibility criteria as a job created or as a job retained for purposes of the bill's provisions must be multiplied by two for purposes of calculating the number of jobs created or jobs retained by a targeted small business if the targeted small business is located in a rural area and is a historically underutilized business. The bill requires at least 65 percent of a rural development fund's investment authority to consist of credit-eligible capital contributions, which are cash investments made by an entity that is subject to state insurance tax liability and that receives in exchange for the investment an equity interest in a rural development fund or, at par value or premium, a debt instrument that has a maturity date of at least five years from the fund's closing date and a repayment schedule that is no faster than level principal amortization over five years.

C.S.H.B. 1718 sets out provisions relating to the comptroller's determinations on each application, including the period for making those determinations and the order in which determinations are made. The bill caps the total investment authority for rural development funds that the comptroller must approve at \$300 million and provides for reductions of investment authority and credit-eligible capital contributions with regard to an application, or simultaneous multiple applications, that would otherwise exceed the cap.

C.S.H.B. 1718 restricts the grounds for denial of an application to the following:

- the application is incomplete or the application fee is not paid in full;
- the application fails to provide sufficient evidence regarding the federal licensing requirement or the requirement to demonstrate qualifying nonpublic investments;
- the revenue impact assessment does not demonstrate that the business plan will result in a sufficient 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 if the application were approved;
- the credit-eligible capital contributions described in the investor affidavits do not meet the required minimum of 65 percent of the total investment authority sought; or
- the comptroller has already approved the total amount of investment authority allowed under the annual cap.

The bill provides for a 15-day period within which an applicant whose application has been denied may provide additional information to the comptroller to complete, clarify, or cure defects in the application and sets out related procedures. This process for supplying additional information does not apply to an application that is denied because the applicant failed to submit required investor affidavits.

C.S.H.B. 1718 requires the comptroller, on approving an application, to provide written notice to the applicant that includes the amount of the approved rural development fund's investment authority and to provide a tax credit certificate to each investor whose affidavit was included in the application with the amount of the investor's credit-eligible capital contribution included on the certificate. The bill requires a fund to do the following not later than the 60th day after receiving the approval notice:

- collect the credit-eligible capital contribution from each investor issued a tax credit certificate; and
- collect one or more investments of cash that equal the portion of the fund's investment authority that is not attributable to the credit-eligible capital contributions, subject to a minimum proportion that must consist of certain equity investments.

The bill requires the fund, not later than the 65th day after receiving the approval notice, to send the comptroller documentation sufficient to prove that the fund has collected such cash investments. The bill establishes that if the fund fails to comply with these collection and documentation requirements, the fund's approval lapses and the corresponding investment authority does not count toward the annual cap on total investment authority approved by the comptroller. The bill provides for the redistribution of lapsed investment authority.

C.S.H.B. 1718 provides for the reduction of tax credits and investment authority for certain failures to make required growth investments as follows:

- the comptroller must reduce, using the calculation established by the bill, the amount of the tax credit on each tax credit certificate issued in connection with an investment in a rural development fund if the fund fails to invest at least 60 percent of the fund's investment authority in growth investments in Texas on or before the second anniversary of the closing date and the comptroller must also reduce the amount of a rural development fund's investment authority by an amount equal to the total amount of reductions made by the comptroller for all tax credit certificates under this bulleted provision;
- the comptroller must reduce, using the calculation established by the bill, the amount of the tax credit on each tax credit certificate issued in connection with an investment in a rural development fund if the fund fails to invest 100 percent of the fund's investment authority in growth investments in Texas on or before the third anniversary of the closing date and the comptroller must also reduce a rural development fund's investment authority by an amount equal to the total amount of reductions for all tax credit certificates under this bulleted provision, subject to the following:
 - the amount of growth investments that a rural development fund may count with respect to a particular targeted small business, including any amount invested in an affiliate of the targeted small business, may not exceed \$5 million; and
 - all growth investments must consist of growth investments in targeted small businesses whose principal business operations are located in, or are relocated to, a rural area in this state; and
- the comptroller must reduce, using the calculation established by the bill, the amount of the tax credit on each tax credit certificate issued in connection with an investment in a rural development fund if, after the third anniversary of the closing date and before the sixth anniversary of such date, the fund fails to maintain growth investments in Texas equal to 100 percent of the fund's investment authority remaining after any reductions and the comptroller must also reduce a rural development fund's investment authority by an amount equal to the total amount of reductions for all tax credit certificates under this bulleted provision, subject to the following:

- the amount of growth investments that a rural development fund may count with respect to a particular targeted small business, including any amount invested in an affiliate of the targeted small business, may not exceed \$7.5 million;
- an investment that is sold or repaid is considered to be maintained if the rural development fund reinvests an amount equal to the capital returned or recovered by the fund from the original investment, excluding any profit realized, in other growth investments in this state on or before the first anniversary of the date the capital is returned or recovered; and
- an amount received periodically by a rural development 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.

C.S.H.B. 1718 provides for the revocation of tax credit certificates and the fund's investment authority with respect to certain distributions or payments as follows:

- the comptroller must revoke each tax credit certificate issued in connection with an investment in a rural development fund if the fund, before it exits the program under the bill's provisions, makes a distribution or payment that results in the fund having less than the bill's requisite portion of the fund's investment authority invested in growth investments in Texas, with respect to the portion that is, as follows:
 - invested in growth investments in Texas; or
 - available for investment in the growth investments and held in cash, U.S. Treasury securities, bonds or notes issued by the state or an agency or political subdivision of the state, or a deposit account with a depository institution headquartered or chartered in Texas; and
- the comptroller must revoke a rural development fund's investment authority if the comptroller revokes the fund's tax credit certificates under the preceding bulleted provision.

C.S.H.B. 1718 provides for the reduction of tax credits and investment authority for related-party investments and the applicability of that reduction, as follows:

- the comptroller must reduce, using the calculation established by the bill, the amount of the tax credit on each tax credit certificate issued in connection with an investment in a rural development fund if, before the fund exits the program under the bill's provisions, the fund 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 and the comptroller must also reduce a rural development fund's investment authority by an amount equal to the total amount of reductions for all tax credit certificates under this bulleted provision;
- the reduction in the amount of the tax credit on each tax credit certificate does not apply to investments in publicly traded securities by a targeted small business or an owner or affiliate of the targeted small business; and
- for purposes of this reduction, a rural development fund is not considered an affiliate of a targeted small business solely as a result of the fund's growth investment in the targeted small business.

C.S.H.B. 1718 provides for the redistribution of the investment authority associated with reducing or revoking a tax credit certificate and investment authority and establishes that reduced or revoked authority does not count toward the annual cap on total investment authority approved by the comptroller. In addition, the bill provides the following matters regarding reduction or revocation:

- the comptroller must notify a fund of the reasons for a pending reduction or revocation before reducing or revoking a tax credit and investment authority; and
- to avoid the reduction or revocation, a fund may correct any violation outlined in such a notice within a specified period.

C.S.H.B. 1718 authorizes a rural development fund, on or after the sixth anniversary of its closing date, to apply to the comptroller to exit the program and no longer be subject to regulation under the bill's provisions. An application to exit the program must be in a form and comply with procedures prescribed by the comptroller and include a calculation of the state reimbursement amount as provided under the bill's provisions. The bill prohibits the unreasonable denial of an application to exit and sets out eligibility criteria, a deadline for the comptroller to respond to the application, and a certain notice requirement in the case of a denial, which must include confirmation of the state reimbursement amount as provided under the bill's provisions. The bill requires the fund, not later than the 60th day after the date the fund receives confirmation of the state reimbursement amount, to remit an amount equal to the lesser of the excess return or the state reimbursement amount determined under the bill's provisions. The bill provides for the calculation of the excess return and the state reimbursement amount. The bill prohibits the comptroller from reducing or revoking the amount of a tax credit on a tax credit certificate related to an investment in a fund after the fund's exit from the program.

C.S.H.B. 1718 authorizes a rural development fund to request from the comptroller a written opinion as to whether a business in which the fund proposes to make a growth investment qualifies as a targeted small business. The bill establishes a deadline and related notice requirement for the comptroller's determination on such a request.

C.S.H.B. 1718 requires the fund to submit an annual report to the comptroller until the fund has exited the program and sets out the contents of that report, including specified information relating to the fund's investments and the jobs created and retained as a result of those investments.

C.S.H.B. 1718 requires a rural development fund that has not exited the program before the first day of a state fiscal year to remit to the comptroller a participation fee in an amount determined by the comptroller to offset the fiscal impact to the comptroller of administering the program. The bill requires the comptroller to prescribe the date on which the fee payment is due and to determine, for each state fiscal year, the following amounts:

- the costs incurred by the comptroller to administer the bill's provisions, less the amount of fund application fees and amounts remitted to the comptroller by a fund under the bill's provisions; and
- the amount of the participation fee each fund is required to pay in connection with the state fiscal year, which must be computed using a specified formula that provides for the comptroller's costs of administration to be paid by the funds in proportion to how much investment authority they have.

The bill requires application fees, amounts remitted to the comptroller by the fund, and participation fees collected under the bill's provisions to be deposited to the credit of the general revenue fund and restricts the appropriation of the fees to the comptroller for purposes of administering those provisions.

C.S.H.B. 1718 requires the comptroller, before the beginning of the 91st Legislature, Regular Session, to submit to the lieutenant governor, speaker of the house of representatives, and each other member of the legislature a report on the economic benefits of the bill's provisions. The bill requires the report to include an assessment of the following:

- the aggregate effects of applicable growth investments, including specified metrics;
- the benefits to the state from cost savings attributable to jobs created and retained by all targeted small businesses, including Medicaid savings, food assistance program savings, and unemployment insurance payment savings; and
- the total positive fiscal effect of those cost savings on the state and local governments.

The bill prohibits the report from including information that is confidential by law and specifies the use of certain data and certain estimation techniques. The bill prohibits the comptroller from accepting applications for approval of rural development funds after January 1, 2024, unless the total positive fiscal effects described by the report exceed the sum of all tax credit certificates issued by the comptroller under the bill's provisions. The bill requires the comptroller to resume accepting applications when this condition is satisfied.

C.S.H.B. 1718 sets out the following definitions for the purposes of its provisions regarding rural development funds:

- "historically underutilized business" means a business certified by the comptroller under state law as a historically underutilized business;
- "rural area" means an area other than a municipality with a population of more than 50,000 or an urbanized area contiguous and adjacent to the municipality or an area determined to be rural in character by the U.S. Department of Agriculture;
- "credit-eligible capital contribution" means an investment of cash that equals the amount specified on a tax credit certificate issued by the comptroller under the bill's provisions made by an entity that is subject to state insurance tax liability, as defined by the bill's insurance tax credit provisions;
- "growth investment" means any capital or equity investment by a rural development fund in a targeted small business or any loan by a rural development fund to a targeted small business with a stated maturity date of at least one year after the date of issuance;
- "investment authority" means the amount stated on the notice issued under the bill's provision approving the rural development fund;
- "jobs created" means, with respect to a targeted small business, employment positions that, as follows: are created by the targeted small business, are located in Texas; require at least 35 hours of work each week; and were not located in Texas at the time of the initial growth investment in the targeted small business; and
- "jobs retained" means, with respect to a targeted small business, employment positions that, as follows: are located in Texas, require at least 35 hours of work each week, and existed before the initial growth investment in the targeted small business and would have been lost or moved out of Texas had a growth investment in the targeted small business not been made, as certified in writing by an executive officer of the targeted small business to the rural development fund.

Moreover, for purposes of the bill's provisions regarding both the rural development funds and the insurance premium tax credits, the bill defines the following:

- "closing date" means the date a rural development fund has collected all of the approved amounts described by the bill; and
- "affiliate" means an entity that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with another entity, applicable to an entity that is controlled by another entity holding, directly or indirectly, the majority voting or ownership interest in the controlled entity or controlling the day-to-day operations of the controlled entity by contract or law.

Insurance Tax Credit

C.S.H.B. 1718 amends the Insurance Code, to make an entity eligible for a credit against the entity's state insurance tax liability for a tax year if the entity holds a tax credit certificate issued in exchange for investment in a rural development fund and the third, fourth, fifth, or sixth anniversary of the fund's closing date occurs during the tax year. With respect to that credit, the bill does the following:

- sets the amount of the credit equal to 25 percent of the amount of the credit-eligible capital contribution stated on the certificate; and
- caps the total credit claimed by an entity for a tax year, including the amount of any carryforward, at the amount of the entity's state insurance tax liability due for the entity for the tax year after applying all other applicable tax credits.

C.S.H.B. 1718 provides the following regarding implementation of the credit:

- credits may be applied to estimated or final tax payments;
- an entity may carry forward unused credit and apply the credit to a subsequent tax report;
- an entity may not convey, assign, or transfer credit to another entity, except to an affiliate of the entity that is liable for state insurance tax; and

- an entity claiming a credit is not required to pay any additional retaliatory tax as a result of claiming that credit.

The bill requires the comptroller to recapture from an entity the amount of a credit claimed on an applicable tax report if the tax credit certificate on which the credit is based is reduced or revoked. The bill requires the comptroller to recapture an amount equal to the amount by which the credit previously claimed exceeds the amount of the reduction or revocation.

C.S.H.B. 1718 establishes that it is the intent of the legislature that each growth investment in a targeted small business made by a rural development fund provides patient, growth-oriented investment capital for purposes including expansion, payroll, inventory, and training, and be at a below market rate with flexible terms, which offers the targeted small business an affordable and borrower-friendly financing alternative.

Rulemaking; Transition

C.S.H.B. 1718 requires the comptroller to adopt rules necessary to implement, monitor, and evaluate the bill's provisions. The comptroller must begin accepting applications for approval of rural development funds not later than October 1, 2023, and the bill's provisions relating to the insurance tax credit apply only to a tax report originally due on or after January 1, 2023.

EFFECTIVE DATE

On passage, or, if the bill does not receive the necessary vote, September 1, 2023.

COMPARISON OF INTRODUCED AND SUBSTITUTE

While C.S.H.B. 1718 may differ from the introduced in minor or nonsubstantive ways, the following summarizes the substantial differences between the introduced and committee substitute versions of the bill.

The substitute includes the following provisions that were not in the introduced:

- a definition for a "historically underutilized business" and requirements for employment positions to be multiplied by two when calculating the number of jobs created and the number of jobs retained by a targeted small business if the targeted business is located in a rural area and is a historically underutilized business;
- with respect to a provision defining "growth investment" and establishing the conditions under which a loan by a rural development fund to a targeted small business is a growth investment, a specification that a loan by a fund to a targeted small business is a growth investment only if the targeted small business obtains an affidavit from the chief executive officer or equivalent position of the targeted small business attesting that the targeted small business sought and was denied similar financing from a commercial bank;
- a specification, with respect to the disposition of fees, that includes applicable amounts remitted by a fund to the comptroller among the other fees that must be deposited to the general revenue fund to be used only for the purpose of administering a fund;
- with respect to the bill provision requiring an application for approval as a fund to include evidence sufficient to prove to the comptroller's satisfaction that, as of the date of the application, the applicant or its affiliates have invested, in the aggregate, at least \$100 million in nonpublic companies, specifications that the nonpublic companies be located in the United States and that the investment of at least \$100 million include at least \$70 million in nonpublic companies located in rural areas in the United States;
- a requirement for an application for approval as a fund to include evidence sufficient to prove to the comptroller's satisfaction that the applicant or its affiliates have maintained principal business operations in Texas for at least four years preceding September 1, 2023, which is set out as an alternative to the bill provision requiring such an application to include as such evidence that at least one principal in a rural business investment company licensed under federal law or a small business investment company licensed under federal

law 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;

- provisions providing for the calculation of a fund's excess return and a fund's state reimbursement amount and, with respect to an application to exit the program:
 - a requirement that the application be in a form and comply with procedures the comptroller prescribes and that it include confirmation of the state reimbursement amount; and
 - a requirement for a fund that applies to exit the program to remit the lesser of the excess return and state reimbursement amount not later than the 60th day after receipt of confirmation of the state reimbursement amount;
- a prohibition on the reduction by the comptroller of the amount of a tax credit on a tax credit certificate related to an investment in a fund after the fund's exit from the program;
- a requirement in the bill's insurance premium tax credit provisions for the comptroller to recapture an amount equal to the amount by which the credit previously claimed exceeds the amount of a reduction of the substitute's reduction or revocation; and
- a provision establishing legislative intent regarding each growth investment in a targeted small business made by a fund under the bill's provisions.

Whereas the introduced authorized the comptroller to approve not more than \$300 million of investment authority in any calendar year, the substitute instead requires the comptroller to approve up to \$300 million without specification that it be in any calendar year.

Whereas the substitute requires the comptroller to adopt rules necessary to implement, monitor, and evaluate the bill's provisions regarding the rural development fund, the introduced required the comptroller to adopt only the rules necessary to implement the bill's provisions regarding the fund.

With respect to the bill's fund capitalization requirements and actions the fund must take after receiving approval notice from the comptroller, the substitute and the introduced prescribe different deadlines for collecting the investments of cash and different deadlines for sending documentation to the comptroller proving the fund has collected the applicable amounts, as follows:

- the substitute sets the 60th day after the date the fund receives the approval notice as the deadline for collecting one or more cash investments but the introduced set the deadline for collecting one or more cash investments at the third anniversary after the closing date, defined by the bill as the date a fund has collected all of the approved amounts described by the bill; and
- the substitute sets the 65th day after receiving such notice as the deadline for sending the documentation of that collection of cash investments to the comptroller but the introduced set the deadline for sending that documentation at the third anniversary after the closing date.

The substitute and the introduced both require revocation of a tax credit certificate if a fund makes certain distributions or payments that result in the fund having less than certain amounts invested in growth investments in Texas or available for investment in growth investments and held in cash, securities, bonds or notes, or a deposit account with a depository institution headquartered or chartered in Texas, but the substitute makes this applicable to a distribution or payment resulting in the fund having less than the portion of the fund's investment authority required to be invested in growth investments in Texas under the bill's provisions whereas the introduced made this applicable to a distribution or payment resulting in the fund having less than all of the amounts collected by the fund as credit-eligible capital contributions and collected as investments of cash.

The introduced did not contain any of the substitute's requirements for the comptroller to reduce the amount of a fund's tax credit on each tax credit certificate and to reduce a fund's investment authority by certain amounts, under applicable circumstances, nor did the introduced provide for the calculations for such reductions as the substitute does. However, the substitute incorporates and repurposes the substantially similar provisions from the introduced that established the grounds

for revocation of a tax credit certificate to make them applicable to the substitute's provisions regarding the applicable reductions.

The substitute, in repurposing the grounds for revocation to make them applicable to the substitute's reduction to a fund's investment authority, provides that the amount of growth that a fund may count with respect to a particular targeted small business, including any amount invested in an affiliate of the targeted small business, may not exceed \$5 million, whereas the introduced set the cap at \$7.5 million, and the substitute further provides that all growth investments, rather than 75 percent of them as in the introduced, must consist of growth investments in targeted small businesses whose principal business operations are located in, or are relocated to, a rural area in Texas.

The substitute, but not the introduced, requires the comptroller to revoke a fund's investment authority if the comptroller revokes tax credit certificates with respect to the distribution or payment that results in the funding having less than the portion of the fund's investment authority invested in growth investments in Texas.