

HOUSE BILL No. 2505

AN ACT relating to income taxation; concerning venture capital; enacting the Kansas certified capital formation company act.

*Be it enacted by the Legislature of the State of Kansas:*

Section 1. This act shall be known and may be cited as the Kansas certified capital formation company act. The purpose of this act is to enhance the development of seed and venture capital in Kansas and to support the modernization and expansion of the state's economy. As used in this act, unless the context clearly requires otherwise, the following terms mean:

(a) "Affiliate of a certified capital formation company" means:

(1) Any person that directly or indirectly, owns, controls or possesses the power or ability to vote ten percent or more of the outstanding voting securities or other beneficial ownership interests of the Kansas certified capital formation company;

(2) any person ten percent or more of whose outstanding voting securities or other beneficial ownership interests are directly or indirectly owned, controlled or possessed with the power to be voted by the Kansas certified capital formation company;

(3) any person directly or indirectly controlling, controlled by, or under common control with the Kansas certified capital formation company;

(4) any partnership in which the Kansas certified capital formation company is a general partner;

(5) any person who is an officer, director, general partner, managing member, managing director or agent of the Kansas certified capital formation company or an immediate family member of such person.

(b) "Affiliate of an investor" means:

(1) Any person that directly or indirectly, owns, controls or possesses the power or ability to vote ten percent or more of the outstanding voting securities or other beneficial ownership interests of the investor;

(2) any person ten percent or more of whose outstanding voting securities or other beneficial ownership interests are directly or indirectly owned, controlled or possessed with the power to be voted by the investor;

(3) any person directly or indirectly controlling, controlled by or under common control with the investor;

(4) a partnership in which the investor is a general partner;

(5) any person who is an officer, director or agent of the investor or an immediate family member of such officer, director or agent.

(c) "Applicable percentage" means 50%.

(d) "Authorized capital formation company and authorized CFC" means a capital formation company that has been designated by the secretary as having met the requirements of this act necessary to raise capital investments but that has not yet received the designation as a certified capital formation company.

(e) "CFC" means any capital formation company.

(f) "Capital in a qualified Kansas business" means any at risk investment in any note, stock, partnership or membership interest or other form of equity investment or hybrid security, of any nature and description whatsoever, including a debt instrument or security which has the characteristics of indebtedness but which provides for conversion into equity or equity participation instruments such as options or warrants which are acquired by a CFC as a result of a transfer of cash to a business, except for debt instruments, the proceeds of which were used to acquire or which will be used to develop intellectual property, in which case such debt instrument may be secured by a lien on the intellectual property. Capital in a qualified Kansas business shall not include secured debt instruments.

(g) "Certified capital" means cash, marketable securities, legally enforceable commitments of capital subject to call by a capital formation company and other assets held by a certified capital formation company equal to the amount of certified capital investment made by investors in the certified capital formation company.

(h) "Certified capital formation company" means any partnership, corporation, trust or limited liability company, whether organized on a profit or not for profit basis, that is domiciled in and qualified to conduct business in Kansas and that has as its primary business activity, the investment of cash in qualified Kansas businesses, and which is certified by the secretary as satisfying the criteria of this act.

(i) “Certified capital investment” means an investment of cash by an investor which is certified by the secretary made in such manner as to acquire a beneficial ownership interest in a Kansas certified capital formation company.

(j) “Commissioner” means the securities commissioner of Kansas or persons acting under the supervision of the commissioner.

(k) “In existence” means the date of the first sale of goods or services by a qualified Kansas business or a business seeking to be so qualified.

(l) “Investor” means any person that invests cash. If the investor is a natural person, the investor shall have a net worth of at least \$1,000,000 and such net worth shall be not less than 10 times the amount of the investor’s certified investment in a CFC. The investor’s net worth shall not include the value of any equity in the investor’s primary residence.

(m) “Liquidating distribution” means any distribution other than a qualified distribution.

(n) “Maximum cumulative investment” means certified capital investment of \$10,000,000 or such lesser amount as the secretary of commerce and housing may prescribe in accordance with subsection (d) of section 4, and amendments thereto.

(o) “Person” means any natural person or any business association, including but not limited to, a corporation, limited liability company, general or limited partnership or trust.

(p) “Qualified distribution” means any distribution or payment made by a certified capital formation company for costs and expenses of forming, syndicating, managing or operating the certified capital formation company, including an annual management fee and reasonable and necessary fees in accordance with industry custom for professional fees including, but not limited to, legal and accounting fees, relating to operating the certified capital formation company.

(q) “Qualified Kansas business” means:

(1) A business that satisfies the requirements of subparagraphs (A) through (F) of this subsection.

(A) Such business is independently owned and operated and has its principal business office located in Kansas or, in the case of a company domiciled outside the state of Kansas, which certifies that the company’s principal business office will be located in Kansas within six months following the date of the initial investment.

(B) At least fifty percent of the employees of the business shall be resident in Kansas or, in the case of a company domiciled outside the state of Kansas, certifies that at least fifty percent of its employees will be resident in Kansas within six months following the date of the initial qualified venture capital investment.

(C) Such business is in need of venture capital and cannot obtain conventional financing to fund its further development and future operations.

(D) Such business shall be engaged in commerce for the purpose of manufacturing, processing or assembling or distributing products, conducting research and development or providing services in interstate commerce.

(E) For businesses involved in commerce for the purpose of providing services in interstate commerce, that business must demonstrate that more than fifty percent of its gross revenues are derived from sales outside the state of Kansas or provide reasonable documentation that the company will derive at least fifty percent of its gross sales outside the state within a three-year period.

(F) Such business, at the time of the initial qualified venture capital investment, shall have been in existence less than five years and shall not have had gross sales in excess of \$1,000,000 in any single fiscal year.

(2) Any business which, subject to paragraph (a)(5) of section 5, and amendments thereto, is approved as a qualified Kansas business at the time of the first qualified venture capital investment in such business by a Kansas certified capital formation company, for a period of five years following the date of such first investment, shall continue to be classified as a qualified Kansas business and may receive follow-on investments from any Kansas certified capital formation company, and such follow-on investments shall constitute qualified venture capital investments even though such business may not meet other qualifications set forth in paragraph (p)(1)(F) at the time of such follow-on investments.

(3) A qualified Kansas business shall not include:

(A) Any commercial enterprise primarily engaged in the sale at retail of goods or services taxable under the Kansas retailer's sales tax act; any service provider set forth in K.S.A. 17-2707, and amendments thereto; any bank, savings and loan or lending institution; any real estate, real estate development or insurance company; or any commercial enterprise deriving its revenues directly from noncommercial customers in exchange for personal services;

(B) an entity engaged primarily as a passive business, in irregular or noncontinuous operations, any financial instrument that derives substantially all of its income from passive investments that generate interest, dividends, royalties or capital gains or any business arrangement the effect of which is to immunize an investor from risk of loss;

(C) a business engaged in oil and gas exploration and development;

(D) a subsidiary of a certified capital formation company;

(E) another certified capital formation company;

(F) an affiliate of the certified capital formation company;

(G) an investor of the certified capital formation company or an affiliate or subsidiary of an investor of the certified capital formation company unless approved in writing by the secretary.

(r) "Qualified venture capital investment" means the investment of cash by a Kansas certified capital formation company in such a manner as to acquire capital in a qualified Kansas business.

(s) "Secretary" means the secretary of commerce and housing or persons under the secretary's direction.

(t) "Tax credit" means a credit against the tax imposed by the Kansas income tax act, the premium tax or privilege fee imposed pursuant to K.S.A. 40-252, and amendments thereto, or the privilege tax as measured by net income of financial institutions imposed pursuant to chapter 79, article 11 of the Kansas Statutes Annotated.

Sec. 2. (a) Any investor that makes a certified capital investment shall earn a tax credit against state tax liability equal to 50% of the amount of such investor's certified capital investment. The investor, or a person to whom the credits were duly transferred, shall be entitled to claim not more than 10% of the credit per taxable year for taxable years commencing on and after January 1, 2005. If the amount of the tax credit allowed under subsection (a) exceeds the tax liability of the taxpayer for any taxable year, such excess amount shall be refunded to the taxpayer.

(b) No certified capital investment in a single CFC by any one person shall be less than \$25,000 or more than \$2,000,000; nor shall any one person's combined investment be deemed in excess of \$5,000,000 for the purpose of earning tax credits.

(c) The total amount of tax credits which may be allowed shall not exceed \$20,000,000. The total amount of tax credits which may be allowed under this act shall not exceed \$2,000,000 per fiscal year.

Sec. 3. (a) The secretary may authorize and subsequently certify profit or not-for-profit entities which meet the requirements of this act. The secretary shall compile a list of every certified CFC, including the address and telephone number of the certified CFC's principal place of business. The secretary shall publicize the list in order to inform Kansas companies of the availability of potential investment capital.

(b) The secretary shall review the organizational documents for each applicant for authorization as a CFC and the business history of the applicant to determine:

(1) That at the time of application, the applicant owns cash, marketable securities and other liquid assets valued at no less than \$500,000; or that prior to January 1, 2000, the applicant was designated as an innovation and commercialization corporation or an affiliate innovation and commercialization corporation created under the Kansas technology enterprise corporation innovation and commercialization corporation program; and

(2) that the officers and the board of directors, general partners, trustees, managing members or managers, as the case may be, are thoroughly acquainted with the requirements of this act and acknowledge such by a signed certification.

(c) To continue to be certified, the CFC must own and shall periodically demonstrate to the secretary, as the secretary may require, that

the liquid asset base for the certified capital formation company is at least \$500,000 at all times during the CFC's participation in the program authorized by this act.

(d) With respect to any person who submits or has submitted an application for authorization as a CFC, the commissioner shall investigate to determine and report to the secretary whether any of the directors, trustees, managers, officers, general partners, beneficial owners of 10% or more of any class of equity securities or any promoters employed or otherwise associated with that person at the time of such application:

(1) Has been affiliated with any company that has filed a registration statement which is subject to a currently effective stop order entered pursuant to any state law;

(2) has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or any felony involving fraud or deceit including, but not limited to, forgery, embezzlement of money under false pretenses, larceny or conspiracy to defraud;

(3) is currently subject to any state administrative order or judgment entered by a state securities administrator or is subject to any state administrative order or judgment in which fraud or deceit was found and an order or judgment was entered;

(4) is currently subject to any state administrative order or judgment which prohibits the use of any exemption from registration in connection with the purchase or sale of securities;

(5) is subject to any order, judgment or decree of any court of competent jurisdiction temporarily or preliminarily restraining or enjoining, or is subject to any order, judgment or decree of any court of competent jurisdiction permanently restraining or enjoining that person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security, rendering investment advice or involving the making or any false filing with any state; and

(6) has been convicted of or pleaded nolo contendere to any criminal offense other than a misdemeanor involving motor vehicle violations.

(e) The secretary shall not authorize any CFC if the commissioner's report includes any affirmative findings pursuant to subsection (d).

(f) The secretary shall review documentation regarding the qualifications of the persons who will actively manage the CFC and make a determination as to whether such persons possessed sufficient knowledge and professional experience in the areas of investment, venture capital, business management and evaluation, portfolio management, and such other area of expertise to the degree that a reasonable person would be confident in such manager's ability to manage the CFC. No authorization shall be issued when it is the opinion of the secretary that such persons do not possess this requisite degree of knowledge and expertise.

(g) No investor shall individually, or collectively with or through one or more affiliates, by means of ownership, agreement or otherwise, own, control or possess the power or ability to cause or direct the making of any qualified venture capital investments by a CFC.

(h) Within a period of time established by the secretary after receiving an application for authorization as a CFC, the secretary shall either issue or deny the authorization and communicate in detail to the applicant the grounds for the denial, including any suggestions for the removal of those grounds.

Sec. 4. (a) A capital formation company having been authorized by the secretary pursuant to section 3, and amendments thereto, shall have a period of not more than 365 days from the date of receiving authorization in which to procure certified capital investment.

(b) In order to receive certification by the secretary, an authorized capital formation company shall raise a minimum aggregate certified capital investment of no less than \$5,000,000. In the case of an authorized capital formation company formed by an innovation and commercialization corporation or an affiliate innovation and commercialization corporation created under the KTEC innovation and commercialization corporation program, such minimum certified capital investment shall be no less than \$1,000,000.

(c) Total certified capital investment deemed certified for the purpose of earning tax credits shall not exceed \$10,000,000 in a single capital formation company.

(d) A CFC is hereby authorized to be formed for the purpose of investing exclusively in nonmetropolitan counties as defined in K.S.A. 74-5093 and amendments thereto. In the case of a CFC formed for such purposes, the secretary may enter into an agreement with the CFC at the time of application to establish a lower minimum or maximum investment. Upon meeting the established cumulative maximum, certification may take place pursuant to subsection (e) of this section.

(e) If during the fund raising period, an authorized capital formation company demonstrates to the secretary that the maximum cumulative certified capital investment has been met pursuant to this act, the secretary shall either designate the capital formation company as a certified capital formation company and notify the secretary of revenue of such certification; or shall deny the certification and notify the capital formation company of the basis for denial.

(f) All capital investment deemed certified for the purpose of earning tax credits must be certified by the investor to be new moneys in that such moneys were not being used for seed or venture capital prior to making the investment in a CFC. Any attempt to transfer funds from an existing venture capital fund to a CFC for the purposes of earning a tax credit shall constitute a violation of this act and may lead to decertification.

(g) No capital investments shall be certified by the secretary until such time when the minimum cumulative certified capital investments are met.

(h) Upon the end of the fund raising period as established by the secretary, capital formation companies that have reached the minimum cumulative certified capital investment requirement but have failed to reach the maximum cumulative certified capital investment requirements shall be certified by the secretary in rank order based on the amount of certified capital investment raised by the capital formation company and the amount of tax credits available for allocation upon the secretary's satisfaction that all such investment was made pursuant to this act.

(i) The secretary will notify the department of revenue upon certification of a capital formation company.

(j) Designation as an innovation and commercialization corporation or an affiliate innovation and commercialization corporation created under the Kansas technology enterprise corporation shall not relieve such entity from compliance with any provisions of this act except where stated otherwise.

Sec. 5. (a) To continue to be certified, a CFC shall make qualified venture capital investments according to the following schedule:

(1) Within three years after the date on which a CFC is certified at least 33% of its capital originally certified shall be, or have been, used for making qualified venture capital investments;

(2) within four years after the date on which a CFC is certified at least 66% of its capital originally certified shall be, or have been, used for making qualified venture capital investments;

(3) within five years after the date on which a CFC is certified at least 100% of its total capital originally certified shall be, or have been, used for making qualified venture capital investments;

(4) a CFC shall not make an investment in an affiliate of the CFC or an affiliate of an investor. For the purposes of this subsection, if a company is not an affiliate before a CFC initially invests in the company, it shall not be deemed to be an affiliate if such CFC provides additional qualified venture capital investment to such company subsequent to its initial investment. No corporate officer, employee or shareholder, no limited or general partner or other person personally affiliated with any CFC shall personally invest in any portfolio company regardless of whether the portfolio company is affiliated with the CFC; and

(5) all certified capital which is not then required to be invested in qualified venture capital investments or which has been previously invested in qualified venture capital investments and returned by the company, may be held or invested in such manner as the CFC, in its discretion, deems appropriate. The proceeds of all certified capital which is returned to a CFC after it was originally invested in qualified venture capital investments, may be invested in other qualified venture capital investments and shall be credited toward any requirement in this act with

respect to placing certified capital in qualified venture capital investments.

(b) A CFC may make qualified distributions at any time. In order to lawfully make liquidating distributions, a CFC must have invested an aggregate amount equal to 100% of its certified capital in qualified venture capital investments or the fair value of its assets plus any prior qualified and liquidating distributions which equal or exceed 110% of its certified capital. In addition, to the extent that marketable securities have been received in liquidation of a qualified venture capital investment, such securities may be distributed as liquidating distributions. Notwithstanding any other provisions of this act, cash liquidating distributions are permitted solely for the purpose of providing funds to investors to pay income taxes attributable to earnings of the CFC.

(c) Liquidating distributions in excess of the certified capital formation company's original certified capital and any additional capital contributions to the certified capital formation company shall be subject to audit by a certified public accounting firm acceptable to the secretary, at the expense of the certified capital formation company.

(d) If at the time any liquidating distribution is made by a CFC, the aggregate sum of all liquidating distributions of the CFC exceeds the aggregate sum of the CFC's original certified capital and any subsequent qualified venture capital contributions to the CFC, as determined by audit, the CFC, prior to any additional distributions, shall pay to the state treasurer's office 10% of the proportion of the distribution in excess of such amount.

(e) Documents and other materials submitted by CFC's or by businesses for purposes of authorization or original certification or the continuance of certification as a CFC shall not be public records if it is determined by the secretary that disclosure of such information would compromise trade secrets of qualified Kansas businesses unless otherwise specified in this act.

(f) Each CFC shall report the following to the secretary:

(1) Within 90 days of the close of the CFC's fiscal year, annual audited financial statements. The audit shall address the methods of operation and conduct of business of the CFC to determine if the CFC is complying with the statutes and program rules and that the funds received by the CFC have been invested in accordance with the time limits provided by this act.

(2) At the end of each quarter, that no more than 20% of the greater of: (A) The original certified capital investment in the CFC; or (B) the original certified capital investment plus the amount equal to the net gains, losses, income and expenses realized by the CFC at such time shall be invested by a CFC in a single qualified Kansas business at any one time unless the CFC can demonstrate that a greater percentage in a single qualified Kansas business at any one time is the result of losses suffered by the CFC in other qualified venture capital investments.

(g) Any material related to the sale of ownership in a CFC or soliciting investment in a CFC shall include the following statement: "By authorizing or certifying a certified capital formation company, the State of Kansas does not endorse the quality of management or the potential for earnings of a particular company. The use of the word "certified" or "authorized" in an offering does not constitute a recommendation or endorsement of an investment by the Kansas Securities Commission or any other State Official."

(h) The secretary may establish reasonable initial filing fees for applications for authorization and certification pursuant to this act and may also establish an annual nonrefundable fee for CFC's seeking continued certification.

Sec. 6. (a) To ensure that no qualified venture capital investment or investor's certified capital investment has been made in violation of this act, the secretary shall conduct an annual review of each CFC to determine if the CFC is complying with the requirements of certification. The costs of the annual review shall be paid by each CFC according to a reasonable fee schedule adopted by the secretary.

(b) Any material violation of this act by a CFC shall be grounds for decertification under this section. If the secretary determines that a CFC is not in compliance with the requirements for continuing certification,

the secretary, by written notice, shall inform the officers of the CFC and the board of directors, managers, trustees or general partners that they shall be decertified within 120 days from the date of mailing of the notice, unless they correct the deficiencies detailed in the notice and demonstrate to the secretary's satisfaction that the CFC is again in compliance with the requirements for certification as determined by the secretary.

(c) At the end of the 120 day grace period, if the CFC is still not in compliance, the secretary may send a notice of decertification to the CFC and to the secretary of revenue including a list of the decertified capital investments by investor and transferee.

(d) Decertification of a CFC prior to the CFC meeting all requirements of paragraphs (1) through (4) of subsection (a) of section 5, and amendments thereto, shall cause the recapture of all tax credits previously allowed to an investor or transferee and the forfeiture of all future tax credits to otherwise be claimed by an investor or transferee with respect to any certified capital investment in the decertified CFC.

(e) Decertification of a CFC after it has met all requirements of paragraphs (1) through (4) of subsection (a) of section 5, and amendments thereto, shall cause the forfeiture of tax credits commencing with the taxable year of the investor or transferee in which the decertification arose and for all future taxable years with no recapture of tax credits allowed to an investor or transferee with respect to the taxable years which ended before the decertification occurred. Once a CFC has invested 100% of its certified capital in qualified Kansas businesses, all future tax credits to be claimed pursuant to this act by investors or transferees with respect to such CFC shall not be subject to recapture.

Sec. 7. The secretary shall prepare and submit an annual report to the governor and the legislature no later than October 1 of each year. Such report shall be presented to the standing committee on commerce in the senate, standing committee on economic development in the house of representatives and the joint committee on economic development. Such report shall include but not be limited to:

(a) The total dollar amount each CFC received from all investors allowed tax credits and any other investors and the identity of all investors allowed tax credits;

(b) the total amount invested by each CFC in qualified Kansas businesses, the identity and location of those businesses, the amount invested in each qualified Kansas business and the total number of permanent full-time jobs created or retained by each qualified Kansas business as a result of the investment; and

(c) the cumulative amount of any liquidating disbursements received by the state from the CFC's.

Sec. 8. The secretary may revoke the certification of a CFC if any material representation to the secretary in connection with the application process proves to have been falsely made or if the application materially violates any requirement established by the secretary.

Sec. 9. (a) Any investor that is not subject to taxation under the provisions of the Kansas income, privilege or premium tax that makes a certified capital investment shall be deemed to acquire an interest in the nature of a transferable 50% tax credit. The credit established pursuant to this act may be sold or transferred subject to approval by the secretary. An investor as described in this section shall not be allowed a refund for the interest herein created. Only the full amount of the credit for any one investment may be transferred, and the credit may be transferred only one time. Documentation of any credit transfer shall be provided to the secretary. The secretary shall transmit a copy of such documentation to the secretary of revenue.

(b) The secretary, after consulting with the secretary of revenue, shall develop such rules and regulations as are necessary to facilitate the operation of the transfer program consistent with the interest of the state in tracking the transfer of ownership and the use of tax credits earned by the transferee.

(c) Any such sale or transfer shall not affect the time schedule for taking the tax credit, as provided in this act. Any tax credits recaptured pursuant to section 6, and amendments thereto, shall be the liability of the taxpayer which actually claimed the tax credit. In approving the sale or transfer of the tax credit pursuant to this section, the secretary may

require the transferor or the transferee or both to execute guarantees or post bonds with respect to any potential tax credit recapture.

(d) Any payment received for tax credits pursuant to this section is taxable income of the transferor of the credit and the amount equal to the difference the dollar value of the tax credit transferred minus the sales price of the tax credit shall be taxable income of the transferee.

(e) The secretary shall make and promulgate rules and regulations consistent with the provisions of this act as are necessary or useful to carry out the provisions of this act.

(f) Every final order, decision, license or other official act of the secretary pursuant to this act is subject to review in accordance with the act for judicial review and civil enforcement of agency actions, K.S.A. 77-601 et seq. and amendments thereto.

(g) In view of the objectives of these requirements and the underlying policies of the act, the act is not available with respect to any transaction or series of transactions that, although in technical compliance with these rules, is part of a plan or scheme to evade the requirements of this act or to distort the benefits entitled to be realized under the act. In such cases, no investor in any CFC shall be entitled to the benefit of any tax credits provided for hereunder.

(h) The offer or sale of a security by a CFC pursuant to this act shall be subject to the registration requirements of K.S.A. 17-1254, 17-1255, 17-1257, 17-1258, 17-1259 and 17-1260, and amendments thereto.

Sec. 10. This act shall take effect and be in force from and after its publication in the statute book.

I hereby certify that the above BILL originated in the HOUSE, and passed that body

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HOUSE adopted  
Conference Committee Report \_\_\_\_\_

\_\_\_\_\_  
*Speaker of the House.*

\_\_\_\_\_  
*Chief Clerk of the House.*

Passed the SENATE  
as amended \_\_\_\_\_

SENATE adopted  
Conference Committee Report \_\_\_\_\_

\_\_\_\_\_  
*President of the Senate.*

\_\_\_\_\_  
*Secretary of the Senate.*

APPROVED \_\_\_\_\_

\_\_\_\_\_  
*Governor.*