

Approved 3-10-87
Date

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC

The meeting was called to order by Senator Wint Winter, Jr. at
Chairperson

12:40 ~~a.m.~~/p.m. on March 3, 1987 in room 529-S of the Capitol.

All members were present except:

Committee staff present:

William Edds, Revisor of Statutes Office
Lynne Holt, Legislative Research Department
Mary Allen, Secretary to the Committee

Conferees appearing before the committee:

David Barclay, Department of Commerce
Pat Thompson, Kansas Capital Development Fund
Mark Burghart, Department of Revenue

The meeting was called to order at 12:40 p.m. by the Chairman, Senator Wint Winter, Jr..

Senate Bill 67 - An Act amending the Kansas venture capital company act; authorizing the acquisition of income tax credits by taxpayers through transfers from investors exempt from income taxation.

Senate Bill 243 - An Act amending the Kansas venture capital company act; concerning income tax credits for investments in certified Kansas venture capital companies.

David Barclay, Department of Commerce, gave a brief explanation of SB 67 and SB 243. He referred to the balloon version of SB 67, prepared by the Department of Commerce, (Attachment I) and stated that it provides that the tax credit can only be transferred one time and it provides a requirement that there be a reporting to the Secretary of Commerce of who receives the transferred credit. Copies of a second balloon version of SB 67, prepared by the Department of Revenue, were passed out to the Committee. (Attachment II)

Mr. Barclay discussed a balloon version of SB 243 (Attachment III) and noted that this version provides that for investment in venture capital companies, the investor gets a twenty-five percent tax credit to be taken over four or more years. This credit can be carried forward. He passed out a list (Attachment IV) of the venture capital companies which are forming and a list of who would be planning to take advantage of the tax credit. He noted that the total expected capitalization of these companies is a little over \$40 million.

Mr. Barclay said that there have been some suggestions regarding modification of the statutes to allow venture capital companies to reserve tax credits in the future based on a pledge to contribute a certain amount now and a certain amount later. He stated that the Department of Commerce continues to have concerns about that proposed modification. First, it appears that the tax credit allowed will probably be used up very quickly and Kansas needs to have as many venture capital companies operating as possible. Second, he said, the ultimate objective is to give the credit for "cash that we have and that we invest this year". He observed that giving credit for cash invested in a future year is fine but it doesn't help the economy now. He urged the Committee not to allow venture capital companies to reserve credit for the future.

Mr. Barclay discussed the \$6 million cap on tax credits for venture capital companies. He said that the tax credits will be allocated, basically, on a first come first serve basis and when the cap is reached, no more tax credits will be allowed. He observed that once the cap is reached, the Legislature would have to allocate an additional amount if it wishes to continue to offer tax credits.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

room 529-S, Statehouse, at 12:40 ~~a.m.~~/p.m. on March 3, 1987.

Mark Burghart, Department of Revenue, told the Committee that there are separate forms which must be filed by those who are seeking the tax credit. He observed that it will be easy to identify those who are filing for this particular credit.

Chairman Winter called on Pat Thompson, Kansas Capital Development Fund, to comment on SB 67 and SB 243. Mr. Thompson stated that a lot of SB 243 is a result of his organization's attorney's work. He said that he has a concern over the allocation of tax credits and specifically the definition in the bills of cash investment. He discussed the process of raising funds for a venture capital company for certification and observed that they don't get cashiers checks made out to the particular venture capital company but rather they get subscription agreements which are binding obligations that have been signed by a particular investor. He stated that he feels that these subscription agreements are the same as money. He noted that if some of these agreements are for one-half of the cash now and one-half a year later, the entire amount of the subscription agreement should be certified.

Mr. Barclay told the Committee that the Department of Commerce met with Mr. Thompson and some other investors and discussed this particular problem. He said that the agreement at that time was that when the venture capital companies come to be certified, if they bring demand notes which indicate that that cash is available, that will suffice as counting as a cash investment. If the cash is not available at that time, it is not a cash investment. He said that if a company comes with a subscription agreement which says that a portion of the cash will be available immediately and a portion will be available next year, only the portion which is available immediately counts as a cash investment in this year. That would be the only portion which could be used to allocate the tax credit.

Mr. Thompson said that it is his position that once you have a binding obligation, that is a cash investment.

Senator Burke moved that the amendments to SB 243 contained in the balloon version of the bill provided by the Department of Commerce (Attachment III) be adopted. Senator Feleciano seconded the motion. The motion carried.

Chairman Winter said that there is concern about whether or not expanding the definition of cash investment in SB 243 would negatively impact the plans of the bankers in KVCII to utilize the SBA leveraging program. Staff had been asked to contact the Kansas Bankers Association to ask them to review this concern. The Chairman observed that the Committee has not received any word from the bankers. Senator Feleciano stated that he wants an opinion directly from the SBA concerning the matter.

The Chairman asked Pat Thompson about the definition of cash investment in SB 243. Mr. Thompson said that the language in SB 243 would expand that definition to include two different types of instruments which could be used as investments in a venture capital fund, those being a debt instrument or an equity interest.

The meeting was adjourned at 1:30 p.m. by the Chairman.

GUEST LIST

NAME

REPRESENTING

PAT THOMPSON

KANSAS CAPITAL DEVELOPMENT
FUND, L.P.
Box 1185 Hutchinson 67504

MARK A. BURGHART

DEPT. OF REVENUE

BUD GRANT

KCCI

Jerry Dudley

Ks Bd of Agric.

Harold Pitts

OBSERVER

David Barclay

DOC

SENATE BILL No. 67

By Legislative Commission on Kansas Economic Development

1-23

0016 AN ACT amending the Kansas venture capital company act;
0017 authorizing the acquisition of income tax credits by taxpayers
0018 through transfers from investors exempt from income taxation;
0019 amending K.S.A. 1986 Supp. 74-8302 and 74-8308 and repeal-
0020 ing the existing sections.

0021 *Be it enacted by the Legislature of the State of Kansas:*
0022 Section 1. K.S.A. 1986 Supp. 74-8302 is hereby amended to
0023 read as follows: 74-8302. The purpose of the Kansas venture
0024 capital company act is to facilitate the formation of private
0025 venture capital companies that meet generally accepted national
0026 standards for private venture capital companies, and that make
0027 equity investments in the creation and expansion of Kansas
0028 businesses which are job and wealth creating enterprises by
0029 granting tax credits against the Kansas income tax liability of
0030 taxpayers investing in such Kansas venture capital companies
0031 and taxpayers acquiring credits pursuant to transfers as pro-
0032 vided in section 2.

0033 New Sec. 2. Any investor that is not subject to taxation under
0034 the provisions of Article 32 of Chapter 79 of the Kansas Statutes
0035 Annotated and that makes a cash investment in a certified Kansas
0036 venture capital company shall be deemed to acquire an interest
0037 in the nature of a transferable credit limited to an amount equal
0038 to 25% of such cash investment. Such interest may be transferred
0039 to a taxpayer and be claimed by such taxpayer as a credit against
0040 the taxpayer's Kansas income tax liability beginning in the tax-
0041 payer's taxable year in which the investment in the Kansas
0042 venture capital company was made. An investor shall not be
0043 entitled to a refund for the interest created under this section. [A
0044 credit acquired by transfer shall be subject to the limitations

A credit may only be transferred one time.

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Attachment I*

0046 prescribed by K.S.A. 1986 Supp. 74-8304 and amendments
0047 thereto. Documentation of any credit acquired by transfer shall
0048 be provided by the taxpayer in the manner required by the
0049 director of taxation.

0049 Sec. 3. K.S.A. 1986 Supp. 74-8308 is hereby amended to read
0050 as follows: 74-8308. (a) Each qualified Kansas venture capital
0051 company shall report to the secretary on an annual basis such
0052 information as the secretary requires to be submitted to maintain
0053 certification. As a part of such information, each Kansas venture
0054 capital company shall report the name, address and taxpayer
0055 identification number of each ~~taxpayer investor~~ who has in-
0056 vested in such company and amounts invested by each such
0057 ~~taxpayer investor~~.

0058 (b) The secretary shall provide this information contained in
0059 subsection (a) to the department of revenue on an annual basis.

0060 (c) The secretary shall conduct an annual review of each
0061 Kansas venture capital company certified under the program to
0062 determine if the Kansas venture capital company is in compli-
0063 ance with the requirements of certification, to advise the Kansas
0064 venture capital company as to the certification status of its
0065 investments, and to ensure that no investment has been made in
0066 violation of the provisions of this act or rules and regulations
0067 promulgated by the department. The reasonable costs of the
0068 annual review shall be paid by each Kansas venture capital
0069 company according to a reasonable fee schedule adopted by the
0070 secretary. Any violation shall be grounds for decertification
0071 under this section.

0072 (d) If the Kansas venture capital company has met the fifth
0073 year, seventh year and ninth year investment levels and has
0074 subsequently sold any of the companies in which those equity
0075 investments were made, the temporary liquidity of the Kansas
0076 venture capital company prior to reinvestment in the equity of
0077 new ventures will not be cause for decertification.

0078 (e) In undertaking the annual review the secretary shall use
0079 reasonable and generally accepted national standards of venture
0080 capital company practice. If the secretary determines that a
0081 company is not in substantial compliance with the requirements

Investors who are exempt from income taxation and who transfer income tax credits to a taxpayer shall report to the Venture Capital Company the name, address and taxpayer identification number of the taxpayer who acquires the credit and the company shall report this information to the Secretary.

0082 for continuing in certification, the secretary shall, by written
0083 notice, inform the officers of the company and the board of
0084 directors or partners that they will be decertified in 120 days
0085 from the date of mailing of the notice unless they correct the
0086 deficiencies and are once again in compliance with the require-
0087 ments for certification.

0088 (f) At the end of the ~~one hundred twenty day~~ 120-day period,
0089 if the Kansas venture capital company is still not in substantial
0090 compliance, the secretary shall send a notice of decertification to
0091 the company and to the secretary of the department of revenue.
0092 Decertification of a Kansas venture capital company shall cause
0093 the forfeiture of any right or interest to the tax credit under the
0094 provisions of this act and shall cause the total amount of tax credit
0095 previously claimed by persons under the program to be due and
0096 payable with that year's income tax liability.

0097 (g) Following each annual examination, the secretary shall
0098 notify the department of revenue of any Kansas venture capital
0099 companies that are not in compliance with this section.

0100 (h) The department of revenue shall send written notice to
0101 the address of each person whose tax credit has been forfeited,
0102 using the address last shown on the person's last income tax
0103 filing.

0104 Sec. 4. K.S.A. 1986 Supp. 74-8302 and 74-8308 are hereby
0105 repealed.

0106 Sec. 5. This act shall take effect and be in force from and
0107 after its publication in the Kansas register.

SENATE BILL No. 67

By Legislative Commission on Kansas Economic Development

1-23

0016 AN ACT amending the Kansas venture capital company act;
0017 authorizing the acquisition of income tax credits by taxpayers
0018 through transfers from investors exempt from income taxation;
0019 amending K.S.A. 1986 Supp. 74-8302 and 74-8308 and repeal-
0020 ing the existing sections.

0021 *Be it enacted by the Legislature of the State of Kansas:*

0022 Section 1. K.S.A. 1986 Supp. 74-8302 is hereby amended to
0023 read as follows: 74-8302. The purpose of the Kansas venture
0024 capital company act is to facilitate the formation of private
0025 venture capital companies that meet generally accepted national
0026 standards for private venture capital companies, and that make
0027 equity investments in the creation and expansion of Kansas
0028 businesses which are job and wealth creating enterprises by
0029 granting tax credits against the Kansas income tax liability of
0030 taxpayers investing in such Kansas venture capital companies
0031 and taxpayers acquiring credits pursuant to transfers as pro-
0032 vided in section 2.

0033 New Sec. 2. Any investor that is not subject to taxation under
0034 the provisions of Article 32 of Chapter 79 of the Kansas Statutes
0035 Annotated and that makes a cash investment in a certified Kansas
0036 venture capital company shall be deemed to acquire an interest
0037 in the nature of a transferable credit limited to an amount equal
0038 to 25% of such cash investment. Such interest may be transferred
0039 to a taxpayer and be claimed by such taxpayer as a credit against
0040 the taxpayer's Kansas income tax liability beginning in the tax-
0041 payer's taxable year in which the investment in the Kansas
0042 venture capital company was made. An investor shall not be
0043 entitled to a refund for the interest created under this section. A
0044 credit acquired by transfer shall be subject to the limitations

Such interest may not be transferred between taxpayers.

Senate Economic Development
3-3-89

Attachment II

SENATE BILL No. 243

By Committee on Economic Development

2-12

0017 AN ACT amending the Kansas venture capital company act;
0018 concerning income tax credits for investments in certified
0019 Kansas venture capital companies; amending K.S.A. 1986
0020 Supp. 74-8303, 74-8304 and 74-8306 and repealing the exist-
0021 ing sections.

0022 *Be it enacted by the Legislature of the State of Kansas:*

0023 Section 1. K.S.A. 1986 Supp. 74-8303 is hereby amended to
0024 read as follows: 74-8303. For the purposes of this act, the fol-
0025 lowing terms shall have the meanings provided herein, unless
0026 the context clearly indicates otherwise:

- 0027 (a) "Department" means the department of commerce;
- 0028 (b) "equity" means all forms of equity such as common stock,
0029 preferred stock with or without voting rights and without regard
0030 to seniority of equity position, forms of subordinate or convert-
0031 ible debt, or both, with warrants or other means of equity
0032 conversion attached, or any other means of financing which meet
0033 generally accepted national standards for venture capital invest-
0034 ment in the United States;
- 0035 (c) "Kansas business" means any small business owned by a
0036 Kansas resident, any partnership, association or corporation
0037 domiciled in Kansas, or any corporation, even if a wholly owned
0038 subsidiary of a foreign corporation, that does business primarily
0039 in Kansas or does substantially all of its production in Kansas;
- 0040 (d) "Kansas venture capital company" means any for-profit
0041 partnership or corporation that has as its primary business activ-
0042 ity the investment of funds in return for equity in ventures that
0043 in need of capital for expansion, new product development or
0044 similar business purposes and that may be certified by the
0045 secretary as meeting the criteria of this act and thus eligible for

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0046 the tax credit provided in this act;

0047 (e) "secretary" means the secretary of the department of
0048 commerce;

0049 (f) "cash investment" means money or its equivalent in con-
0050 sideration for:

0051 (1) An equity interest, such as a general or limited partner-
0052 ship interest, common or preferred stock with or without voting
0053 rights and without regard to seniority position, forms of subor-
0054 dinate or convertible debt, or both, with warrants or other
0055 means of equity conversion attached; or

0056 (2) a debt instrument, such as a note or debenture, which is
0057 unsecured, subordinated to the general creditors of the debtor,
0058 and requires no payments of principal (other than principal
0059 payments required to be made out of any future profits of such
0060 debtor) for at least a seven-year period after commencement of
0061 its term.

0062 Sec. 2. K.S.A. 1986 Supp. 74-8304 is hereby amended to read

0063 as follows: 74-8304. (a) ~~There shall be allowed as a credit against~~

0064 ~~the tax imposed by the Kansas income tax act on the Kansas~~
0065 ~~taxable income of a taxpayer for a cash investment in a certified~~
0066 ~~Kansas venture capital company in an amount equal to 25% of~~
0067 ~~such taxpayer's cash investment in any such company in the~~
0068 ~~taxable year in which such investment is made and the taxable~~
0069 ~~years following such taxable year until the total amount of the~~
0070 ~~credit is used. In any one taxable year, the amount of such total~~
0071 ~~credit allowable for deduction from the taxpayer's tax liability~~
0072 ~~shall not exceed 25% of the total amount of such credit, and, in no~~
0073 ~~case, may such amount exceed be limited to the lesser of 25% of~~
0074 ~~such total credit, and 25% of the taxpayer's tax liability in such~~
0075 ~~year. The amount by which that portion of the credit allowed by~~
0076 ~~the preceding sentence to be claimed in any one taxable year~~
0077 ~~exceeds 25% of the taxpayer's liability in such year may be~~
0078 ~~carried back for not more than three taxable years or carried~~
0079 ~~forward until the total amount of the credit is used. Subject to the~~
0080 ~~preceding limitations in any one taxable year:~~

0081 (1) Such credit is allowable in the taxable year in which such
0082 cash investment is made;

There shall be allowed as a credit against the tax imposed by the Kansas income tax act on the Kansas taxable income of a taxpayer for cash investment in a certified Venture Capital Company in an amount equal to 25% of such taxpayer's cash investment in any such certified Venture Capital Company in the taxable year in which such investment is made and the taxable years following such taxable year until the total amount of the credit is used. In any one taxable year, the amount of such credit allowable for deduction from the taxpayer's tax liability shall not exceed 25% of the total amount of such credit plus any applicable carryforward amount. The amount by which that portion of the credit allowed by the preceding sentence to be claimed in any one taxable year exceeds the taxpayer's liability in such year may be carried forward until the total amount of the credit is used.

0083 ~~(2) to the extent the otherwise allowable credit is limited by~~
0084 ~~tax liability limitation in any taxable year, the difference be-~~
0085 ~~tween the tax credit limitation and the tax liability limitation in~~
0086 ~~such taxable year may be carried back three taxable years (to be~~
0087 ~~applied to the earliest such carryback year first);~~

0088 ~~(3) after application of subdivision (2) above, any remaining~~
0089 ~~unused total credit may be carried back to taxable years com-~~
0090 ~~mencing after December 31, 1985, (to be applied to the earliest~~
0091 ~~such carryback year first); and~~

0092 ~~(4) after application of subdivisions (2) and (3) above, any~~
0093 ~~remaining unused total credit may be carried over to subse-~~
0094 ~~quent taxable years until such total credit is used in full.~~

0095 (b) The secretary of revenue ~~may~~ shall allow credits that are
0096 attributable to not more than \$24,000,000 of cash investments in
0097 certified Kansas venture capital companies, which shall include
0098 not more than \$10,000,000 for Kansas Venture Capital, Inc. The
0099 credits shall be allocated ~~to~~ by the secretary for cash invest-
0100 ments in certified Kansas venture capital companies in the order
0101 that completed applications for designation as Kansas venture
0102 capital companies are received by the secretary. Allocations by

0103 ~~the secretary of such credit shall be made based upon commit-~~
0104 ~~ted future cash investments, including those contingent solely~~
0105 ~~upon certification, as well as uncommitted cash investments~~
0106 ~~expected to be committed or made within 90 days of certifica-~~
0107 ~~tion. Any such expected uncommitted cash investments which~~
0108 ~~are not in fact made or committed within such ninety-day~~
0109 ~~period and with respect to which the certified Kansas venture~~
0110 ~~capital company has not so demonstrated to the secretary in~~
0111 ~~writing to have been made within 100 days of certification, shall~~
0112 ~~forfeit their allocation of such credit. Any certified Kansas~~

0113 ~~venture capital company may apply to the secretary at any time~~
0114 ~~for additional allocation of such credit based upon then com-~~
0115 ~~mitted cash investments, but priority as to such additional~~
0116 ~~allocation shall be determined at the time of such subsequent~~
0117 ~~application. Notwithstanding the provisions of subsection (c),~~
0118 ~~investors in Kansas venture capital companies established after~~
0119 ~~July 1, 1984, which otherwise meet the requirements specified~~

0120 in this act, shall be, upon certification of the Kansas venture
0121 capital company, entitled to the tax credit provided in subsection
0122 (a) in the calendar year in which the investment was made.

0123 (c) No taxpayer shall claim a credit under this section for cash
0124 investment in Kansas Venture Capital, Inc. No Kansas venture
0125 capital company shall qualify for the tax credit allowed by
0126 Chapter 332 of the 1986 Session Laws of Kansas for investment
0127 in stock of Kansas Venture Capital, Inc.

0128 (d) The provisions of this section shall be applicable to all
0129 *cash investments made in any taxable years year* commencing
0130 after December 31, 1985, and prior to January 1, 1993.

0131 Sec. 3. K.S.A. 1986 Supp. 74-8306 is hereby amended to read
0132 as follows: 74-8306. (a) The secretary shall promulgate rules and
0133 regulations for making an application for certification of a Kansas
0134 venture capital company and shall specify the information that
0135 must be submitted at the time of application. No Kansas venture
0136 capital company shall be certified until the secretary has adopted
0137 rules and regulations as required in K.S.A. 1986 Supp. 74-8305
0138 *and amendments thereto*. A company seeking to be certified as a
0139 Kansas venture capital company must specify the level of ~~cap-~~
0140 ~~italization~~ *cash investment* that the company expects to qualify
0141 for the tax credits provided for in this act. The application must
0142 show that the applicant's purpose is to encourage and assist in
0143 the creation, development and expansion of Kansas businesses
0144 and to provide maximum opportunities for the employment of
0145 Kansans by making venture capital available to Kansas busi-
0146 nesses as described and defined in K.S.A. 1986 Supp. 74-8303
0147 *and amendments thereto*.

0148 (b) The department, through the secretary, shall review the
0149 articles of incorporation or the articles of partnership of each
0150 applicant for certification and the business history of the appli-
0151 cant and determine that the capitalization is at least \$1,500,000.

0152 (c) Within 60 days of application, the secretary shall issue the
0153 certification and notify the department of revenue of such cer-
0154 tification, or shall refuse the certification and issue an order so
0155 providing.

0156 Sec. 4. K.S.A. 1986 Supp. 74-8303 74-8304 and 74-8306 are

0157 hereby repealed.

0158 Sec. 5. This act shall take effect and be in force from and
0159 after its publication in the Kansas register.

Possible Certifications for Tax Credits

The following information provides a listing of those venture capital funds which are interested in qualifying their investors for Kansas income tax credits.

| <u>Fund</u> | <u>Location</u> | <u>Date Expected</u> | <u>Expected Capitalization</u> | <u>Tax Credit</u> |
|---|-----------------|----------------------|--------------------------------|-------------------|
| Kansas Venture Capital, Inc. | Topeka | 4/87 | \$10,000,000 ¹ | \$2,500,000 |
| Capital Research Mgmt. Group ² | Lawrence | 12/86 | \$ 1,575,600 | \$ 393,900 |
| R.A.B. Ventures, Inc | Overland Pk. | 3/87 | \$ 2,000,000 | \$ 500,000 |
| Kansas Capital Dev. Fund | Hutchinson | 5/87 | \$ 6,000,000 | \$1,500,000 |
| | | 5/88 | \$ 6,000,000 | \$1,500,000 |
| Campbell-Becker #2 | Lawrence | 7/87 | \$ 5,000,000 | \$1,250,000 |
| Central Systems Dev, Inc. | Wichita | | \$ 1,500,000 | \$ 375,000 |
| Management Group | Wichita | | \$10,000,000 | \$2,500,000 |
| Local Seed Capital Funds | | | <u>unknown</u> | <u>unknown</u> |
| TOTALS | | | \$42,075,600 | \$10,518,900 |

¹ Proposed legislation (1987 SB 70) would allow \$1.5 million of current investment to be counted as new capitalization toward the \$10 million required for State investment of \$10 million. If it passes, this would mean that the tax credit would be 25 percent of \$8.5 million or \$2.125 million.

² Certified as a Kansas venture capital company on December 9, 1986. This company was organized by Sam Campbell and Charles Becker of Lawrence.

Prepared by: Department of Commerce
3/3/87

Senate Eco Div
3-3-87
Attachment ~~IV~~