

Approved 3-10-87
Date

MINUTES OF THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT

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

12:45 ~~a.m.~~/p.m. on March 5, 1987 in room 527 S of the Capitol.

All members were present except: Senator Feleciano - Excused
Senator Salisbury - Excused

Committee staff present:

Arden Ensley, Revisor of Statutes
Lynne Holt, Legislative Research Department
Tom Severn, Legislative Research Department
Mary Allen, Secretary to the Committee

Conferees appearing before the committee:

David Barclay, Department of Commerce
Mark Burghart, Department of Revenue

The meeting was called to order at 12:45 p.m. by the Chairman, Senator Wint Winter, Jr..

Senator Vidricksen moved that the minutes of the February 24, 1987, February 25, 1987, and February 26, 1987, meetings of the Committee be approved. Senator Hayden seconded the motion. The motion carried.

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 act; concerning income tax credits for investments in certified Kansas venture capital companies.

The Chairman reminded the Committee that at its last meeting it adopted the amendments to SB 243 which had been proposed by the Department of Commerce. He recalled that the Committee had discussed the definition of cash investment in SB 243, had discussed whether or not reservation of tax credits should be allowed, and had also discussed whether venture capital companies should be required to have actual cash on hand or should promissory notes or some other equivalent be allowed in order to reserve and receive tax credits.

David Barclay, Department of Commerce, told the Committee of a poll which he made of the following people: Two out of state venture capital companies, one in St. Louis and one in Denver; Campbell and Becker; Tim O'Sullivan, the tax attorney who worked on SB 243; Belden Daniels; and Kenneth Koger at KPERS. Mr. Barclay said that in this poll he focused on four issues: (1.) Definition of cash investment; (2.) Allocation of credit and whether or not credit should be allocated for a pledge of an investment at some time in the future; (3.) How the certification itself takes place and whether the company has to have actual cash in order to be certified; and (4.) Is it better to have more smaller venture capital funds or fewer larger venture capital funds?

Mr. Barclay reported on the first question regarding whether or not a cash investment, which means both an equity investment and a loan to a venture capital company, should be allowed. His poll revealed that this is a very unusual practice and one which is not used in the venture capital industry. He noted that there was a feeling that it would not be a good idea to do this unless the loan itself is very similar to equity. He said that all of those polled agreed that in situations where a loan is being made to a venture capital company, because of its nature, the loan will be in a preferred position to the people who made an equity investment and, consequently, since it is in a preferred position, should get a lower tax credit, depending on the particular instrument and the particular arrangement between the investor and the venture capital company. Mr. Barclay suggested that the Committee might want to consider staying with a straight equity investment.

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Mr. Barclay discussed the second question in his poll, whether or not the state should allocate a credit in the future to a venture capital company and the investor for the pledge that they make. He said that he was told that (1.) staggered payments are, in fact, the industry practice; (2.) the key is that investors have certainty in their investment in that they know what the tax credit which they receive will be in future years; (3.) there were differing opinions as to whether or not a subscription agreement is really binding.

Mr. Barclay spoke of the third issue, how the mechanism for certification should work, should the companies be required to have cash in hand or should there be a period of time allowed during which they can raise that cash. He noted that two options were discussed: (1.) Start with subscription agreements to make an investment in a venture capital company. When the Department of Commerce gets ready to certify the company, the company could convert those agreements to cash by using an escrow account at a bank. (2.) Provide by statute for a temporary certification for some type of conditional certification. The venture capital company could come to the DOC with subscription agreements, the Department could conditionally certify them and give the company a certain number of days in which to produce the cash itself, such as one to two weeks. When the conversion to cash was completed, the company would receive final certification. Mr. Barclay said that from the standpoint of the Department of Commerce, it is easier administratively to use the escrow account option.

In regard to the question of whether it is better to have fewer large venture capital funds or more small ones, Mr. Barclay said that of those he polled, half favored fewer large and half favored more small.

Tom Severn, Legislative Research Department, reported to the Committee that he visited on the telephone with a Mr. Delaney in Washington, D. C., and was told by him that the SBIC will leverage three to one only against equity.

The Chairman questioned the meaning in line 49 of SB 243 of the words "or its equivalent" which are contained in the definition of cash investment. Arden Ensley, Revisor of Statutes, said that it would be well for the Committee to decide the meaning of those words and to set it out in the bill. Chairman Winter stated that the Committee needs to decide whether to require cash or whether to allow something other than cash, i.e. notes to pay in the future, in order to reserve and receive tax credits.

Senator D. Kerr passed out a balloon version of SB 243 (Attachment I) which contains proposed amendments concerning the definition of cash investment. He said that one of the amendments proposes that in order for a venture capital company to qualify for certification and a tax credit, one half of the money or its equivalent of the company has to be in the form of cash for an equity interest or cash for a debt instrument and one half in a contract of commitment which must be paid within one year of certification.

It was observed that the purpose of Section 1 (f)(2) of SB 243 as it regards debt instruments in the definition of cash investment, is to allow special funds such as KPERS, which cannot invest directly but can invest via debentures or notes, to invest in venture capital companies. Senator Kerr said that the language regarding debt instruments needs to be clarified in the bill. Senator D. Kerr stated that he thinks that the language used is IRS language and that he is not sure that it can be changed. Chairman Winter noted that this subsection is in the bill to allow pension funds to make investments in venture capital companies. He suggested that the Revisor, in connection with the tax lawyers, work on the language in the subsection to make it readable. He said that the policy before the Committee is whether or not to allow anyone to make a debt type of investment or whether to limit the application of debt investments to retirement funds. He observed that the way SB 243 reads, anyone would be allowed credit for a debt type investment.

The Chairman said that the proposal in Senator D. Kerr's proposed amendment is to allow the reservation of tax credit and certification in venture capital companies for investments of half cash now and a contractual obligation for half cash within twelve months.

Senator D. Kerr moved to amend SB 243 as shown in the balloon version of the bill (Attachment I). Senator Langworthy seconded the motion. The motion carried.

Chairman Winter observed that under existing law, insurance companies are not allowed a tax credit for investment in private venture capital companies. He stated that the only companies who are allowed a credit for investment in private companies are those who pay

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income tax. He observed that banks do not pay income tax, they pay a privilege tax, and insurance companies do not pay income tax, they pay a premium tax.

Senator D. Kerr moved that SB 243 be amended to allow insurance companies a tax credit for investment in private venture capital companies. Senator Vidricksen seconded the motion. The motion carried.

Senator Burke offered a conceptual motion that SB 243 be amended to make it clear that one is entitled to the tax credit in the year the cash is actually paid rather than in the year the note is given. Senator Daniels seconded the conceptual motion. The conceptual motion carried.

Senator Burke moved that SB 243 be recommended favorably for passage as amended. Senator D. Kerr seconded the motion. The motion carried.

Senator Karr moved that the amendments to SB 67 as appear in the balloon version of the bill (Attachment II) be adopted and that it be made clear in the bill that credit may be transferred only once and only in total. Senator D. Kerr seconded the motion. The motion carried.

Senator Karr moved that SB 67 be reported favorably for passage as amended. Senator D. Kerr seconded the motion. The motion carried.

The meeting was adjourned by the Chairman at 1:40..

GUEST LIST

NAME

REPRESENTING

CHARUMI KRISHN

KV

D. Barcoy

DOE

S. WARD

BD OF AG

MARK A. BURGHART

DEPARTMENT OF REVENUE

he tax credit provided in this act;

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

(f) "cash investment" ~~means money or its equivalent in consideration for~~

(1) ~~an equity interest, such as a general or limited partnership interest, common or preferred stock with or without voting rights and without regard to seniority position, forms of subordinate or convertible debt, or both, with warrants or other means of equity conversion attached; or~~

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

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

as follows: 74-8304. (a) ~~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 a cash investment in a certified Kansas venture capital company in an amount equal to 25% of such taxpayer's cash investment in any such 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 total credit allowable for deduction from the taxpayer's tax liability shall not exceed 25% of the total amount of such credit, and, in no case, may such amount exceed be limited to the lesser of 25% of such total credit, and 25% of the taxpayer's tax liability in such year. The amount by which that portion of the credit allowed by the preceding sentence to be claimed in any one taxable year exceeds 25% of the taxpayer's liability in such year may be carried back for not more than three taxable years or carried forward until the total amount of the credit is used. Subject to the foregoing limitations in any one taxable year:~~

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

Money or its equivalent in consideration for an

Money or its equivalent in consideration for

; or
3) the face value of a contract of commitment which requires 1/2 of the face value of the contract to be made by investment as defined in (1) and (2) above and for the other 1/2 to be made within one year of certification in a certified Venture Capital company.

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.

Adm. Serv. Div.
3-5-87
Attachment I

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.

*Senate Committee on Economic Development
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Attachment II*

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Attachment II*

0043 prescribed by K.S.A. 1986 Supp. 74-8304 and amendments
0046 thereto. Documentation of any credit acquired by transfer shall
0047 be provided by the taxpayer in the manner required by the
0048 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 a 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.