

MINUTES OF THE HOUSE COMMITTEE ON NEW ECONOMY.

The meeting was called to order by Chairperson Mason at 3:30 p.m. on March 6, 2001 in Room 522-S of the Capitol.

All members were present except: All present

Committee staff present: Bob Nugent, Revisor of Statutes  
Renae Jefferies, Revisor of Statutes  
April Holman, Legislative Research Department  
Lynne Holt, Legislative Research Department  
Rose Marie Glatt, Secretary

Conferees appearing before the committee: Charles Ranson, President, Kansas, Inc.  
Kevin Carr, Vice President of Investments and  
Commercialization, KTEC

Others attending: See Attached List

**HB 2505 - Relating to income taxation; concerning venture capital**

The Chairman reminded the committee that the bill had been double referred to the House Tax and the New Economy Committees. There had been a hearing in New Economy on February 20, and he asked Charles Ranson, President, Kansas, Inc. to brief the committee.

Mr. Ranson, Kansas, Inc. spoke in support of **HB 2505** that offers a 50 percent tax credit against tax liability as an inducement to qualified investors to capitalize for investment firms authorized to do business as certified Capital Formation Companies (Attachment 1). He stated that they have agreed on a 50% tax credit, but the difference remains in the dollar amounts of the total investment (\$50 million or \$25 million). He believes the bill offers a solid framework with which to strengthen the Kansas economy. Mr. Ranson answered questions of Committee members.

Chairman Mason expressed appreciation for the three entities efforts in drafting **HB 2505**. He reviewed the process of the bill during the 2001 session, explaining how he had decided to set the amount at \$50 million instead of \$25 million. Discussion followed reviewing the pros and cons of that action.

Kevin Carr, explained the balloon addressing three amendments made by Dick West, Wichita Technology Ventures (Attachment 2). Chairman Mason read a letter from Lt. Gary Sherrer, acknowledging Mr. West's amendments, however due to time constraints he had not analyzed the amendments, therefore could neither support or oppose them. It was noted that further work was needed to clean up the language for clarification purposes.

It was moved by Representative Kuether to accept the amendments to HB 2505 suggested by Mr. West, as well as the technical changes. The motion to amend was seconded by Representative Cox and carried on a voice vote.

Concern was voiced about the broad authority, to make final decisions, that was given to the Secretary of Commerce in the bill. Discussion followed about qualified investments and staffing needs for the program.

It was moved by Representative Findley that HB2505 be passed out favorably as amended. Representative Kuether seconded and the motion passed by a voice vote.

Representative Long moved for the approval of the Committee minutes for February 15. Representative Compton seconded the motion which passed on a voice vote.

The meeting was adjourned at 4:30 p.m. The next meeting date is March 8, on call of the Chair.



**Testimony in Support of HB 2505**  
**House New Economy Committee**  
**Charles R. Ranson, President**  
**Kansas, Inc.**  
**March 6, 2001**

Mr. Chairman and Members of the Committee.

I appreciate the opportunity to come before you today to speak in support of HB 2505, a bill to satisfy the well documented need for seed and venture capital with which to support the growth of Kansas' economy. HB 2505 accomplishes this objective by offering a 50 percent tax credit against personal, corporate, premium or privilege tax liability as an inducement to qualified investors to capitalize for profit, privately managed, privately owned, privately funded, and publicly regulated investment firms authorized to do business as certified Capital Formation Companies.

This bill represents the culmination of more than three years work. Beginning in 1998 with a Kansas, Inc sponsored "best practices" study of successful seed and venture capital programs around the country, our focus was on how to meet the capital needs of Kansas entrepreneurs without direct state investment in recipient companies. Given our history with KPERS and Ad Astra programs, it was deemed essential that whatever proposal came forward emphasize transparency and accountability, and that it safeguard against the State (or its instrumentality) picking "winners and losers." Also, it was imperative that our program protect from disclosure of sensitive trade secrets the important proprietary interests of businesses that receive investment. Finally, it was deemed essential that the proposed program meet the need of growing concerns that have the potential to diversify and strengthen an economy still reliant on traditional pillars of strength that are increasingly unreliable as the underpinnings of Kansas' 21<sup>st</sup> century economy. HB 2505 meets all of these tests, and I am pleased to commend it for your favorable consideration.

Kansas regularly places near the bottom among states in venture capital investment. One recent measure reports that annualized per capita venture capital investment in the U.S. amounted to \$130.91. In that report, the per capita investment in Kansas was \$9.88. In the same report, per capita venture capital investment in Colorado amounted to \$328.84, and in Missouri, to \$52.16. Make no mistake, Mr. Chair and Members, just as capital is highly mobile in today's market so too are the companies that willingly relocate if they must to satisfy their capital needs. Kansas reports a sad litany of young, vibrant, entrepreneurial companies that, since we began our efforts, have relocated out-of-state or been sold to out-of-state interests as they seek to satisfy their needs for growth capital. The most striking example of this is Knowledge Communications, but the list is extensive, containing Food Labs, Agri-Technologies, HELP Innovations, Newteck, Brite Voice Systems and Coaches Edge.

Mr. Chairman, HB 2505 gives us the opportunity to keep the next generation of companies like those mentioned here at home. It creates within KDOCH a self-funding program to certify and to monitor the operations of between 3 and 10 Capital Formation Companies, the final number of firms depending upon the final authorized tax credit – be it \$25 million, \$12.5 million, or some amount in between.

It provides clear criteria for who can invest, how investments will be made, how tax credits will be earned and redeemed, and what will be the consequences for failure by a CFC to abide by the requirements of the law. It requires annual reporting by the CFCs and it gives to the Secretary of KDOCH audit authority. It spreads the impact of the tax credit over a ten year period by specifying that no more than ten percent of the total allowable tax credit may be redeemed in any given year, beginning in the fiscal year commencing July 1, 2003. Finally, it provides that the State shall receive 10 percent of the profits of each CFC as compensation for extending the tax credit.

HB2505 will promote new industry development. It will create thousands of new jobs, It will result in new tax revenues. And it will establish a defense against the further out-migration of so many of our best and brightest as we seek to build a strong 21st Century Kansas economy.

Mr. Chairman, members of the Committee, I represent to you that there remains only one unresolved issue in HB 2505. That issue is the ultimate size of the allowable tax credit. Secretary Sherrer, Mr. Bendis, and I, joined by staff from KDOCH and the Governor's office, have worked diligently to reconcile the issues that separated the parties last year. Great progress was made, and Secretary Sherrer's constructive comments have resulted in an improved bill.

While differences have been substantially narrowed as a result of these productive, good faith discussions, differences have not been totally erased. During our discussions we agreed that a 50 percent tax credit was a logical, targeted inducement to investors. But, with that tax credit, do we carryover our efforts from last year to raise a total of \$50 million for investment (with a \$25 million tax credit program) or do we reduce our goal to \$25 million in capital raised (and a resulting \$12.5 million tax credit program)? It is this issue, and this issue alone that separates the state's economic development agencies from presenting a unified front in support of HB 2505.

But, this is what the legislative process is about. It is about reconciling differences such as this and, Mr. Chairman, I have confidence in this committee (and in your colleagues in the House and Senate) to resolve the issue of the size of the tax credit in a way that fairly and equitably meets the needs of a growing economy in a manner consistent with our capacity over time to to make this investment that all agree is essential to the long-range economic well-being of our state.

Mr. Chairman, having begun work on the issue of developing a seed and venture capital bill on the day I assumed the presidency of Kansas more than three years ago, this agency's commitment has been and remains to achieve passage of legislation that is workable, that meets the needs of Kansas' entrepreneurs, and that will inspire public confidence through its transparency and accountability measures.

We know that Kansas has lost opportunities to grow exciting new companies and to diversify its economy over the past several years because we did not have in place a program to meet the risk capital needs of our best and brightest entrepreneurs at the critical seed stage in the life of their companies.

While there are recommendations that have been offered for our consideration in the last few days to increase the workability of HB 2505, I believe that HB 2505 offers a solid framework with which to strengthen our economy. It will broaden the set of initiatives that we have in place to support economic development. Mr. Chairman and Members, there is no disagreement concerning the need for this Legislature to act to provide risk capital. In urging you to report HB 2505 favorably, I respectfully tell you that we cannot afford to wait another year to address this need.

Thank you for your consider, Mr. Chairman and Members. I am pleased to stand for your questions.



**HOUSE BILL No. 2505**

By Committee on Federal and State Affairs

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AN ACT relating to income taxation; concerning venture capital; enact-  
ing 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 se-  
curities 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 un-  
der 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 for-  
mation 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 se-  
curities 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 un-

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1 der common control with the investor;

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

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

5 (c) "Applicable percentage" means 50%.

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

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

2 (f) "Capital in a qualified Kansas business" means any at risk invest-  
3 ment in any note, stock, partnership or membership interest or other form  
4 of equity investment or hybrid security, of any nature and description  
5 whatsoever, including a debt instrument or security which has the char-  
6 acteristics of indebtedness but which provides for conversion into equity  
7 or equity participation instruments such as options or warrants which are  
8 acquired by a CFC as a result of a transfer of cash to a business. Capital  
9 in a qualified Kansas business shall not include secured debt instruments.

10 (g) "Certified capital" means cash, marketable securities, legally en-  
11 forceable commitments of capital subject to call by a capital formation  
12 company and other assets held by a certified capital formation company  
13 equal to the amount of certified capital investment made by investors in  
14 the certified capital formation company.

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

21 (i) "Certified capital investment" means an investment of cash by an  
22 investor which is certified by the secretary made in such manner as to  
23 acquire a beneficial ownership interest in a Kansas certified capital for-  
24 mation company.

25 (j) "Commissioner" means the securities commissioner of Kansas or  
26 persons acting under the supervision of the commissioner.

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

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

, 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

a commitment to invest or

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.

~~(5) a CFC, at least 30 working days prior to making what it determines to be any initial qualified venture capital investment, shall first certify to the secretary that the company in which it proposes to invest meets the definition of a qualified Kansas business pursuant to section 1, and amendments thereto. The CFC shall state the amount of capital it intends to invest and identify the business in which it intends to make the investment. The CFC shall also provide to the secretary a written explanation of the basis for its determination that the business meets the definition of a qualified Kansas business, if the secretary determines that the business does not meet the definition of a qualified Kansas business, the secretary, within the 30-working-day period prior to the making of the proposed investment, shall notify the CFC of the determination and provide the CFC an explanation thereof. If the secretary fails to notify the CFC of the determination within the 30-working-day period pre-~~



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scribed herein, the business in which the CFC proposes to invest shall be deemed to be a qualified Kansas business. If a CFC fails to notify the secretary prior to making an initial investment in a business, the business in which the CFC invested shall be deemed not to be a qualified Kansas business even though the business, at the time of the investment, met the requirements of section 1, and amendments thereto.

(6) 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.

(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