House Legislative Analysis Section
House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

SBT CREDIT FOR INSURERS: CERTIFIED CAPITAL COMPANIES

House Bill 4850
Sponsor: Rep. Andrew Raczkowski
Committee: Commerce

Complete to 6-6-01

A SUMMARY OF HOUSE BILL 4850 AS INTRODUCED 5-30-01

The bill would create a new act under which single business tax (SBT) credits would be available to a "certified investor" (defined as an insurance company) investing in a "certified capital company" that provided capital to one or more small businesses headquartered and principally operating in Michigan (referred to as "qualified businesses"). At least 20 percent of investments of a certified capital company would have to be in young businesses engaged in high-technology activity (as described later). The act would be administered by the Department of Treasury, which would have the authority to promulgate rules. Credits would first be available for the tax year beginning January 1, 2002.

Under the bill, a certified investor (an insurance company) that made an investment of certified capital in a certified capital company would, at the time of investment, earn a vested credit against SBT liability equal to 100 percent of the investment of certified capital. An investor would be entitled to take up to 10 percent of the vested tax credit in any tax year beginning with the tax year during which the investment was made. A credit could not exceed tax liability in any tax year, but unused credits could be carried forward. An investor claiming an SBT credit could not as a result be required to pay any additional retaliatory tax under the Insurance Code. A tax credit could be transferred or sold to another certified investor. The bill would limit the total amount of credits for all taxpayers to $200 million. (The term "certified capital" would be defined to mean an investment of cash by a certified investor in a certified capital company which fully funds the purchase price of an equity interest in the company or a qualified debt instrument.)

Certified capital companies. A certified capital company would have to be certified by the Department of Treasury. At the time of seeking certification, a capital company's net worth would have to be at least $500,000, as determined by unencumbered cash, marketable securities, and other liquid assets. The application process would include a criminal background investigation and fingerprint cards and resumes detailing work experience for all principals of the capital company. At least two principals of the company or a person employed to manage the company's funds would be required to have at least two years of experience in the venture capital industry. There would be a nonrefundable application fee of $7,500 for a company seeking certification. There would also be an annual, nonrefundable certification fee of $5,000 payable to the department on or before January 31 of each year. (This would not be due if that date was within six months of the initial allocation date of the company.) A company could be decertified for not complying with the new act's requirements and tax credits could be recaptured.

A certified capital company could be a partnership, corporation, trust, or limited liability company organized on a profit or not for profit basis. Its primary business activity would have to be the investment of cash in qualified businesses. No insurance company or affiliate of an insurance company could directly or indirectly beneficially own ten percent or more of the voting securities of a certified capital company, manage such a company or control its investments.

Qualified Businesses. A "qualified business" would be a business that 1) was headquartered and had its principal business operations in the state and 2) was a small business concern, as defined in the regulations of the federal Small Business Administration. (Those regulations define what constitutes a small business based usually on either the number of employees or the amount of annual receipts. The definition varies by kind of business or business sector.) The term would not apply to businesses predominantly engaged in professional services provided by accountants, lawyers, or physicians. A business classified as a qualified business at the time of the first investment would remain as such for follow-on investments even though it no longer met the definition at the time of the follow-on investments. Further, the Department of Treasury could determine that a business was a qualified business even if it did not meet the definition if the department determined that an investment in the business by a certified capital company would further economic development in the state.

Early Stage Business/High Technology. At least 20 percent of the qualified investments made by a certified capital company would have to be in early stage qualified businesses engaged in high technology activity as determined by the Michigan Economic Development Corporation (MEDC). Generally speaking, an "early stage business" would be one that was less than two years old, had gross revenues of no more than $3 million, and was engaged in activities related to the development of initial product or service offerings, including prototype development of initial product or service offerings and the prototype development or establishment of initial or production service processes. The definition of "high-technology activity" would be the same as found in the Michigan Economic Growth Authority (MEGA) Act.

Tax Credit Allocations. A certified investor/insurance company would make a "tax credit allocation claim" to the Department of Treasury on a form provided by the department; the claim would include the statement that the investor was legally bound and irrevocably committed to make an investment of a specified amount of certified capital in a certified capital company. Credits would be allocated in the order that claims were received by the department. If total claims exceeded the amount of credits available, credits would be allocated on a pro rata basis (as specified in the bill). Within ten days of receiving a claim, the department would have to notify the investor of the amount of tax credits allocated to that investor. If an investor did not invest capital in a certified capital company within 10 business days after receiving an allocation, the certified investor would forfeit that portion of the allocation not invested and the forfeited amounts would be reallocated. (The bill would specify that the department could not approve a tax credit allocation claim for an insurance company, on an aggregate basis with its affiliates, exceeding $10 million or 25 percent of the total maximum aggregate of claims, whichever was greater.)

Investments by capital companies. The bill would require that a certified capital company invest at least 30 percent of its certified capital within three years after its allocation date and at least

50 percent of its certified capital within five years after its allocation date. No qualified investment could be made at a cost greater than 15 percent of the total certified capital of the company at the time of the investment. Before making an investment in a business, the company could request a written opinion from the Department of Treasury as to whether the company was a qualified business (or a high-technology business). The department would have to provide its opinion within ten days. If it failed to respond within that time, the business in question would be considered a qualified business. The department, as mentioned earlier, could determine that a business was a qualified business (or high-technology business) even if it did not meet the definition if the department determined that an investment in the business by a certified capital company would further economic development in the state. Once a company had invested 100 percent of its capital, it would no longer be subject to the act and could no longer be decertified or have any tax credits recaptured. (The term "qualified investment" would mean the investment of cash by a certified capital company in a qualified business for the purchase of any debt, equity, or hybrid security, of any nature and description.)

Reports by capital companies. A company would be required to report to Department of Treasury and the MEDC the name of each certified investor, the investor's tax identification number, the amount invested and the amount of tax credits, and the date capital was received. This information would have to be reported "as soon as practicable" after the capital was received. On or before January 31 of each year, the company would have to report the amount of its certified capital at the end of the immediately preceding calendar year, whether or not the company had invested more than 15 percent of its capital in any one business, and all the qualified investments made during the immediately preceding calendar year. The company would also have to provide, within 90 days after the close of its fiscal year, an audited financial statement that included the opinion of an independent certified public accountant. Further, on or before January 31 of each year, the company would have to provide an annual report of the economic impact of the investments made in the immediately preceding calendar year, with specific identification in businesses involved in high-technology activities.

State review of companies/Decertification. The Department of Treasury would be required to conduct an annual review of each certified capital company to determine if it was abiding by the requirements of certification, to advise the company as to the eligibility status of its qualified investments, and to ensure that the company's investments had not been made in violation of the act. The department could charge a company no more than $5,000 for the annual review.

Any material violation of the investment and reporting requirements of the act would be grounds for decertification of a company. If the department determined a company was not in compliance, it would inform the company officers that it could be subject to decertification in 120 days unless the deficiencies were corrected and the company was once again in compliance. If the company was not in compliance after the 120 days, the department could send a notice of decertification to the company and all appropriate state agencies.

Recapture of tax credits. Decertification of a company could cause the recapture of tax credits previously claimed and the forfeiture of future credits to be claimed by certified investors. Decertification before a company had met the three-year, 30 percent investment requirement would cause the recapture of all tax credits previously claimed and the forfeiture of all future tax credits. Decertification that met that requirement but failed to meet the five-year, 50 percent investment requirement would mean that 70 percent of allocated tax credits would be subject to recapture or forfeiture. If a certified capital company met both of the abovementioned requirements, but was subsequently decertified, 50 percent of the tax credits would subject to recapture or forfeiture if the decertification occurred within three years after the allocation date. Once a company had invested an amount cumulatively equal to 100 percent of its certified capital in qualified investments, tax credits would no longer be subject to recapture or forfeiture. The Department of Treasury would be required to send written notice to each certified investor whose tax credit had been recaptured or forfeited.

Qualified Distributions. A certified capital company could make qualified distributions at any time. In order to make a distribution other than a qualified distribution or a distribution or payment to debt holders, the company would need to have made qualified investments in an amount cumulatively equal to 100 percent of its certified capital, with at least 20 percent of its capital invested in early stage businesses engaged in high-technology activities. A "qualified distribution" would be defined in the bill to mean a distribution or payment from certified capital in connection with reasonable costs and expenses of forming and syndicating the company or in connection with reasonable costs and expenses of managing and operating the company. The management and operating expenses could include an annual management fee up to 2.5 percent of the certified capital. A distribution could also be made in connection with any projected increase in federal or state taxes, including penalties and interest, of the equity owners resulting from the earnings or other tax liability of the company or the owners, to the extent the increase was related to the ownership, management, or operation of the company or the issuance, repayment, or redemption of qualified debt instruments.

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.