

10105225D

HOUSE BILL NO. 1384

AMENDMENT IN THE NATURE OF A SUBSTITUTE

(Proposed by the House Committee on Finance
on February 10, 2010)

(Patron Prior to Substitute—Delegate Merricks)

A BILL to amend the Code of Virginia by adding in Chapter 25 of Title 58.1 an article numbered 3, consisting of sections numbered 58.1-2532 through 58.1-2552, relating to tax credits against the state license tax on certain insurance companies.

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Chapter 25 of Title 58.1 an article numbered 3, consisting of sections numbered 58.1-2532 through 58.1-2552, as follows:

Article 3.

License Tax Credit for Investment in Virginia Small Business Investment Companies.

§ 58.1-2532. Definitions.

As used in this article, unless the context requires a different meaning:

"Affiliate" of another person means:

1. A person who directly or indirectly:

a. Beneficially owns 15 percent or more of the outstanding voting securities or other voting or management interests of the other person, whether through rights, options, convertible interests, or otherwise; or

b. Controls or holds power to vote 15 percent or more of the outstanding voting securities or other voting or management interests of the other person;

2. A person with 15 percent or more of the outstanding voting securities or other voting or management interests of which are directly or indirectly:

a. Beneficially owned by the other person, whether through rights, options, convertible interests, or otherwise; or

b. Controlled or held with power to vote by the other person;

3. A partnership in which the other person is a general partner; or

4. An officer, director, employee, or agent of the other person, or an immediate family member of the officer, director, employee, or agent.

"Allocation date" means the date on which the participating investors in a Virginia small business investment company are allocated designated capital by the Director under this article.

"Designated capital" means an investment of cash by a participating investor in a Virginia small business investment company that fully funds the purchase price of an equity interest in the company or a qualified debt instrument issued by the Virginia small business investment company.

"Director" means the Director of the Department of Business Assistance.

"License tax credit allocation claim" means a claim for allocation of license tax credits.

"Participating investor" means an insurance company or other person that has state license tax liability, other than a title insurance company, that contributes designated capital pursuant to an allocation of license tax credits under this article.

"Person" means a natural person or entity, including a corporation, general or limited partnership, or trust or limited liability company.

"Qualified business" means a business that, at the time of a Virginia small business investment company's first investment in the business:

1. Is headquartered in the Commonwealth and intends to remain in the Commonwealth after receipt of the investment by the Virginia small business investment company;

2. Has its principal business operations located in the Commonwealth and intends to maintain business operations in the Commonwealth after receipt of the investment by the Virginia small business investment company;

3. Has agreed to use the qualified investment primarily to:

a. Support business operations in the Commonwealth, other than advertising, promotion, and sales operations that may be conducted outside of the Commonwealth; or

b. In the case of a start-up company, establish and support business operations in the Commonwealth, other than advertising, promotion, and sales operations that may be conducted outside of the Commonwealth;

4. Has not more than 100 employees and:

a. Employs at least 80 percent of its employees in the Commonwealth; or

b. Pays at least 80 percent of its payroll to employees in the Commonwealth;

5. Is primarily engaged in:

- 60 a. Manufacturing, processing, or assembling products;
61 b. Conducting research and development; or
62 c. Providing services;
63 6. Is not primarily engaged in:
64 a. Retail sales;
65 b. Real estate development;
66 c. The business of insurance, banking, or lending; or
67 d. The provision of professional services provided by accountants, attorneys, or physicians; and
68 7. Is not a franchise of and has no financial relationship with a Virginia small business investment
69 company or any affiliate of a Virginia small business investment company prior to a Virginia small
70 business investment company's first qualified investment in the business.
- 71 A business classified as a qualified business at the time of the first qualified investment in the
72 business will remain classified as a qualified business and may receive continuing qualified investments
73 from any Virginia small business investment company. Continuing investments will constitute qualified
74 investments even though the business may not meet the definition of a qualified business at the time of
75 such continuing investments.
- 76 "Qualified debt instrument" means a debt instrument issued by a Virginia small business investment
77 company, at par value or a premium, that:
78 1. Has an original maturity date of at least four years after the date of issuance;
79 2. Has a repayment schedule that is not faster than a level principal amortization over four years;
80 and
81 3. Has no interest or payment features that allow for the prepayment of interest or are tied to the
82 profitability of the Virginia small business investment company or the success of its investments.
- 83 "Qualified distribution" means any distribution or payment by a Virginia small business investment
84 company in connection with:
85 1. The reasonable costs and expenses of forming, syndicating, managing, and operating the company,
86 provided that the distribution or payment is not made directly or indirectly to a participating investor,
87 including:
88 a. Reasonable and necessary fees paid for professional services, including legal and accounting
89 services, related to the formation and operation of the company; and
90 b. An annual management fee in an amount that does not exceed two percent of the designated
91 capital of the company; and
92 2. Any projected increase in federal or state taxes, including penalties and interest related to state
93 and federal income taxes, or the equity owners of the company resulting from the earnings or other tax
94 liability of the company to the extent that the increase is related to the ownership, management, or
95 operation of the company.
- 96 "Qualified investment" means the investment of cash by a Virginia small business investment
97 company in a qualified business for the purchase of any debt, debt participation, equity, or hybrid
98 security of any nature or description, including a debt instrument or security that has the characteristics
99 of debt but that provides for conversion into equity or equity participation instruments such as options
100 or warrants.
- 101 "State license tax liability" means any liability incurred by any person under Article 1 (§ 58.1-2500
102 et seq.).
- 103 "Strategic investment area" means any population census tract in which:
104 1. The poverty rate for such tract is at least 20 percent; or
105 2. a. In the case of a tract located outside a metropolitan area, the median family income for such
106 tract does not exceed 80 percent of statewide median family income; or
107 b. In the case of a tract located within a metropolitan area, the median family income for such tract
108 does not exceed 80 percent of the greater of statewide median family income or the metropolitan area
109 median family income.
- 110 "Virginia small business investment company" means a partnership, corporation, or trust or limited
111 liability company, whether organized on a profit or not-for-profit basis, that: (i) has its principal office
112 located or is headquartered in Virginia and (ii) has as its primary business activity the investment of
113 cash in qualified businesses and that is certified as meeting the criteria of this article.
- 114 § 58.1-2533. Duties of Director; regulations.
- 115 A. The Director shall administer this article. No later than January 1, 2011, the Director, in
116 consultation with the State Corporation Commission, shall publish guidelines related to the
117 administration of this article. The guidelines shall be exempt from the Administrative Process Act
118 (§ 2.2-4000 et seq.).
- 119 B. The Director may adopt regulations, in consultation with the State Corporation Commission, as
120 necessary to implement this article. The regulations shall be exempt from the Administrative Process Act
121 (§ 2.2-4000 et seq.).

§ 58.1-2534. Certification.

A. The Director shall establish the application procedures for Virginia small business investment companies.

B. An applicant must file an application on the form prescribed by the Director accompanied by a nonrefundable application fee of \$7,500. The application must include an audited balance sheet of the applicant, with an unqualified opinion from an independent certified public accountant, as of a date not more than 35 days before the date of the application.

C. To qualify as a Virginia small business investment company:

1. The applicant must have, at the time of application, an equity capitalization of at least \$500,000 in the form of unencumbered cash or cash equivalents;

2. At least two principals or persons employed to manage the funds of the applicant must have at least five years of experience in the venture capital or private equity industry; and

3. The applicant must satisfy any additional requirement imposed by the Director.

D. The Director shall review the application, organizational documents, and business history of each applicant and shall ensure that the applicant satisfies the requirements of this article.

E. Not later than the thirtieth day after the date an application is filed, the Director shall:

1. Issue the certification; or

2. Refuse to issue the certification and communicate in detail to the applicant the grounds for the refusal, including suggestions for the removal of those grounds.

§ 58.1-2535. Management by certain entities prohibited.

A. An insurance company, group of insurance companies, or other persons who may have state license tax liability or the affiliates of the insurance companies may not, directly or indirectly:

1. Manage a Virginia small business investment company;

2. Beneficially own, whether through rights, options, convertible interests, or otherwise, more than 10 percent of the outstanding voting securities of a Virginia small business investment company; or

3. Control the direction of investments for a Virginia small business investment company.

B. Subsection A applies without regard to whether the insurance company or other person or the affiliate of the insurance company or other person is licensed by or transacts business in the Commonwealth.

C. This section does not preclude a participating investor, insurance company, or any other party from exercising its legal rights and remedies, including interim management of a Virginia small business investment company, if authorized by law, with respect to a Virginia small business investment company that is in default of its statutory or contractual obligations to the participating investor, insurance company, or other party.

§ 58.1-2536. Offering material used by a Virginia small business investment company.

Any offering material involving the sale of securities of the Virginia small business investment company must include the following statement: "By authorizing the formation of a Virginia small business investment company, the Commonwealth of Virginia does not endorse the quality of management or the potential for earnings of the company and is not liable for damages or losses to a participating investor in the company. Use of the word 'certified' in an offering does not constitute a recommendation or endorsement of the investment by the Director. If applicable provisions of law are violated, the Commonwealth of Virginia may require forfeiture of unused license tax credits and repayments of used license tax credits."

§ 58.1-2537. Requirements for continuance of certification.

A. To continue to be certified, a Virginia small business investment company shall make qualified investments according to the following schedule:

1. Before the second anniversary of an allocation date, a Virginia small business investment company must have made qualified investments in an amount cumulatively equal to at least 35 percent of the designated capital allocated on such date of which at least 25 percent shall be in strategic investment areas; and

2. Before the third anniversary of an allocation date, a Virginia small business investment company must have made qualified investments in an amount cumulatively equal to at least 50 percent of the designated capital on such date of which at least 25 percent shall be in strategic investment areas.

B. The aggregate cumulative amount of all qualified investments made by the Virginia small business investment company after its allocation date shall be considered in the computation of the percentage requirements under this article. Any proceeds received from a qualified investment may be invested in another qualified investment and count toward any requirement in this article with respect to investments of designated capital.

C. Nothing in this article shall limit an insurance company's ownership of nonvoting equity interests in a Virginia small business investment company.

D. A business that is classified as a qualified business at the time of the first investment in the

business by a Virginia small business investment company remains classified as a qualified business and may receive follow-on investments from any Virginia small business investment company. Except as provided by this section, a follow-on investment made under this section is a qualified investment even though the business may not meet the definition of a qualified business at the time of the follow-on investment. A follow-on investment does not qualify as a qualified investment if, at the time of the follow-on investment, the qualified business no longer has its principal business operations in the Commonwealth.

E. A qualified investment may not be made at a cost to a Virginia small business investment company greater than 15 percent of the total designated capital of the company at the time of investment.

F. If, before the ninetieth day after the date that a Virginia small business investment company makes an investment in a qualified business, the qualified business moves its principal business operations from the Commonwealth, the investment may not be considered a qualified investment for purposes of the percentage requirements under this article.

G. A Virginia small business investment company shall invest any designated capital not invested in qualified investments only in the following:

1. Cash deposited with a federally insured financial institution;
2. Certificates of deposit in a federally insured financial institution;
3. Investment securities that are obligations of the United States or its agencies or instrumentalities or obligations that are guaranteed fully as to principal and interest by the United States;
4. Debt instruments rated at least "A" or its equivalent by a nationally recognized credit rating organization, or issued by, or guaranteed with respect to payment by, an entity whose unsecured indebtedness is rated at least "A" or its equivalent by a nationally recognized credit rating organization, and which indebtedness is not subordinated to other unsecured indebtedness of the issuer or the guarantor;
5. Obligations of the Commonwealth or any political subdivision of the Commonwealth; or
6. Any other investments approved in advance and in writing by the Director.

H. If, within five years after an allocation date, a Virginia small business investment company has not invested at least 80 percent of the designated capital allocated on such date in qualified investments, of which at least 25 percent shall be in strategic investment areas, the Virginia small business investment company shall not be permitted to pay management fees.

I. If, within seven years after an allocation date, a Virginia small business investment company has not invested at least 100 percent of the designated capital allocated on such date in qualified investments, of which at least 25 percent shall be in strategic investment areas, the Virginia small business investment company shall not be permitted to pay management fees.

§ 58.1-2538. Evaluation of business by Director.

A. A Virginia small business investment company may, before making an investment in a business, request from the Director a written opinion as to whether the business in which it proposes to invest is a qualified business and is located in a strategic investment area.

B. The Director shall, not later than the fifteenth business day after the date of the receipt of a request pursuant to subsection A, determine whether the business meets the definition of a qualified business, and notify the Virginia small business investment company of the determination and an explanation of its determination or notify the Virginia small business investment company that an additional 15 days will be needed to review and make the determination.

C. If the Director fails to notify the Virginia small business investment company with respect to the proposed investment within the period specified by subsection B, the business in which the company proposes to invest shall be considered to be a qualified business or to be located in a strategic investment area.

§ 58.1-2539. Reports to Director; audited financial statement.

A. Each Virginia small business investment company shall report to the Director as soon as practicable after the receipt of designated capital:

1. The name of each participating investor from whom the designated capital was received, including the participating investor's insurance license tax identification number;
2. The amount of each participating investor's investment of designated capital and license tax credits;
3. The date on which the designated capital was received; and
4. The qualified investments that have been made in strategic investment areas.

B. Not later than January 31 of each year, each Virginia small business investment company shall report to the Director:

1. The amount of the company's designated capital at the end of the preceding year;
2. Whether or not the company has invested more than 15 percent of its total designated capital in any one business without specific approval of the Director;

3. Each qualified investment that the company made during the preceding year and, with respect to each qualified investment, the number of employees of the qualified business at the time the qualified investment was made; and

4. Any other information required by the Director.

C. Not later than April 1 of each year, the company shall provide to the Director an annual audited financial statement that includes the opinion of an independent certified public accountant. The audit shall address the methods of operation and conduct of the business of the company to determine whether:

1. The company is complying with this article;

2. The funds received by the company have been invested as required within the time provided by § 58.1-2537; and

3. The company has invested the funds in qualified businesses, which shall include strategic investment area qualifying information, if applicable.

§ 58.1-2540. Renewal.

A. Not later than January 31 of each year, each Virginia small business investment company shall pay a nonrefundable renewal fee of \$5,000 to the Director. If a Virginia small business investment company fails to pay its renewal fee on or before that date, the company must pay, in addition to the renewal fee, a late fee of \$5,000 to continue its certification.

B. Notwithstanding subsection A, a renewal fee is not required within six months of the date on which the company's certification is issued under § 58.1-2534.

§ 58.1-2541. Distributions; repayment of debt.

A. A Virginia small business investment company may make a qualified distribution at any time. To make a distribution or payment, other than a qualified distribution, a company must have made qualified investments in an amount cumulatively equal to 100 percent of its designated capital.

B. Notwithstanding subsection A, a company may make repayments of principal and interest on its indebtedness without any restriction, including repayments of indebtedness of the company on which participating investors earned license tax credits.

C. If a business in which a qualified investment is made relocates its principal business operations to another state during the term of the Virginia small business investment company's investment in the business, the cumulative amount of qualified investments made by the Virginia small business investment company for purposes of satisfying the requirements of subsection A only is reduced by the amount of the Virginia small business investment company's qualified investments in the business that has relocated. This shall not apply if the business demonstrates that it has returned its principal business operations to the Commonwealth not later than the ninetieth day after the date of its relocation.

D. If a business in which a qualified investment is made that was also in a strategic investment area relocates its principal business operations to another strategic investment area in the Commonwealth, the investment shall remain a qualified investment located in a strategic investment area. If a business in which a qualified investment is made that was also in a strategic investment area relocates its principal business operations to another part of the Commonwealth that is not a strategic investment area, the investment shall remain a qualified investment, but shall not be considered made in a strategic investment area. In such event, the Virginia small business investment company shall have 180 days to comply with subsections A, H, or I of § 58.1-2537, if such relocation results in noncompliance.

§ 58.1-2542. Annual review; decertification.

A. The Director shall conduct an annual review of each Virginia small business investment company to:

1. Ensure that the company continues to satisfy the requirements of this article and that the company has not made any investment in violation of this article; and

2. Determine the eligibility status of its qualified investments.

B. The cost of the annual review shall be paid by each Virginia small business investment company according to a reasonable fee schedule adopted by the Director.

C. A material violation is grounds for decertification of the Virginia small business investment company. If the Director determines that a company is not in compliance with subsection A of § 58.1-2537 or § 58.1-2539 or 58.1-2540, the Director shall notify the officers of the company in writing that the company may be subject to decertification after the one-hundred-twentieth day after the date of mailing of the notice, unless the deficiencies are corrected and the company returns to compliance with those sections.

D. The Director may decertify a Virginia small business investment company, after opportunity for hearing, if the Director finds that the company is not in compliance with subsection A of § 58.1-2537 or § 58.1-2539 or 58.1-2540 at the end of the period established by subsection C. Decertification under this subsection is effective on receipt of notice of decertification by the company. The Director shall notify any appropriate state agency of the decertification.

306 § 58.1-2543. *Administrative penalty.*

307 A. *The Director may impose an administrative penalty on a Virginia small business investment*
308 *company that violates this article.*

309 B. *The amount of the penalty may not exceed \$25,000, and each day a violation continues or occurs*
310 *is a separate violation for the purpose of imposing a penalty. The amount of the penalty shall be based*
311 *on:*

312 1. *The seriousness of the violation, including the nature, circumstances, extent, and gravity of the*
313 *violation;*

314 2. *The economic harm caused by the violation;*

315 3. *The history of previous violations;*

316 4. *The amount necessary to deter a future violation;*

317 5. *Efforts to correct the violation; and*

318 6. *Any other matter that justice may require.*

319 § 58.1-2544. *Recapture and forfeiture of license tax credits; decertification of company.*

320 A. *Decertification of a Virginia small business investment company may cause the recapture of*
321 *license tax credits previously claimed and the forfeiture of future license tax credits to be claimed by*
322 *participating investors with respect to the company, as follows:*

323 1. *Decertification of a company on or before the third anniversary of its allocation date causes the*
324 *recapture of any license tax credit previously claimed and the forfeiture of any future license tax credit*
325 *to be claimed by a participating investor with respect to the company;*

326 2. *For a company that has met the requirements for continued certification under subdivisions A 1*
327 *and A 2 of § 58.1-2537 and is subsequently decertified, any license tax credit that has been or will be*
328 *taken by a participating investor on or before the fifth anniversary of the allocation date is not subject*
329 *to recapture or forfeiture, but any license tax credit to be taken after the fifth anniversary of the*
330 *allocation date is subject to forfeiture only if the company is decertified on or before the fifth*
331 *anniversary of its allocation date; and*

332 3. *For a company that has invested an amount cumulatively equal to 100 percent of its designated*
333 *capital in qualified investments, any license tax credit claimed or to be claimed by a participating*
334 *investor is not subject to recapture or forfeiture under this section.*

335 B. *The Director shall send written notice to the address of each participating investor whose license*
336 *tax credit is subject to recapture or forfeiture, using the address shown on the last license tax filing.*
337 *The State Corporation Commission shall collect any amounts specified in such notice of recapture in the*
338 *same manner as an assessment of license tax.*

339 § 58.1-2545. *Indemnity agreements and insurance authorized.*

340 A. *A Virginia small business investment company that may agree to indemnify, or purchase insurance*
341 *for the benefit of, an investor for losses resulting from the recapture or forfeiture of license tax credits*
342 *under § 58.1-2544. Any guaranty, indemnity, bond, insurance policy, or other payment undertaking made*
343 *under this section may not be provided by more than one participating investor of the Virginia small*
344 *business investment company or affiliate of the participating investor.*

345 § 58.1-2546. *License tax credit.*

346 A. *A participating investor who makes an investment of designated capital shall in the year of*
347 *investment earn a vested credit against state license tax liability equal to 100 percent of the*
348 *participating investor's investment of designated capital, subject to the limits imposed by this article. A*
349 *participating investor may take up to 20 percent of the vested license tax credit in any taxable year*
350 *beginning on or after January 1, 2014.*

351 B. *The credit to be applied against state license tax liability in any one year may not exceed the*
352 *state license tax liability of the participating investor for the taxable year. Any unused credit against*
353 *state license tax liability may be carried forward indefinitely until the license tax credits are used.*

354 C. *A participating investor claiming a credit against state license tax liability earned through an*
355 *investment in a company is not required to pay any additional retaliatory tax levied under this chapter*
356 *as a result of claiming that credit.*

357 § 58.1-2547. *License tax credit allocation claim form.*

358 A. *A license tax credit allocation claim must be prepared and executed by a participating investor on*
359 *a form provided by the Director. The Virginia small business investment company must file the claim*
360 *with the Director. The license tax credit allocation claim form must include language under which the*
361 *participating investor becomes legally bound and irrevocably committed to make an investment of*
362 *designated capital in a Virginia small business investment company in the amount allocated even if the*
363 *amount allocated is less than the amount of the claim, subject only to the receipt of an allocation under*
364 *§ 58.1-2549.*

365 B. *A participating investor may not claim a license tax credit under § 58.1-2546 for an investment*
366 *that has not been funded, even if the participating investor has committed to fund the investment.*

367 § 58.1-2548. *Total limit on credits.*

A. The total amount of designated capital for which license tax credits may be allowed under this article for all years in which license tax credits are allowed is \$100 million.

B. The total amount of designated capital for which license tax credits may be allowed for all participating investors under this article may not exceed the amount that would entitle all participating investors in Virginia small business investment companies to take total credits of \$20 million in a year.

C. A Virginia small business investment company and its affiliates may not file license tax credit allocation claims in excess of the maximum amount of designated capital for which license tax credits may be allowed as provided in this section.

§ 58.1-2549. Pro rata allocation of credits.

A. If the total license tax credits claimed by all participating investors exceeds the total limits on license tax credits established by subsection A of § 58.1-2548, the Director shall allocate the total amount of license tax credits allowed under this article to participating investors in Virginia small business investment companies on a pro rata basis in accordance with this section.

B. The pro rata allocation for each participating investor shall be the product of:

1. A fraction, the numerator of which is the amount of the license tax credit allocation claim filed on behalf of the participating investor and the denominator of which is the total amount of all license tax credit allocation claims filed on behalf of all participating investors; and

2. The total amount of designated capital for which license tax credits may be allowed under this article.

C. Not later than March 1 of each year, the Director shall notify each Virginia small business investment company of the amount of tax credits allocated to each participating investor. Each Virginia small business investment company shall notify each participating investor of their license tax credit allocation.

D. If a Virginia small business investment company does not receive an investment of designated capital equaling the amount of license tax credits allocated to a participating investor for which it filed a license tax credit allocation claim before the end of the tenth business day after the date of receipt of notice of allocation, the company shall notify the Director by overnight common carrier delivery service and that portion of capital allocated to the participating investor shall be forfeited. The Director shall reallocate the forfeited capital among the participating investors in the other Virginia small business investment companies that originally received an allocation so that the result after reallocation is the same as if the initial allocation under this section had been performed without considering the license tax credit allocation claims that were subsequently forfeited.

E. The maximum amount of designated capital for which license tax credit allocation may be allowed on behalf of any one participating investor and its affiliates, whether by one or more Virginia small business investment companies, may not exceed 25 percent of the maximum aggregate amount available under subsection A of § 58.1-2548.

§ 58.1-2550. Impact of tax credits claimed by a participating investor on insurance rates.

A participating investor is not required to reduce the amount of license tax included by the investor in connection with ratemaking for any insurance contract written in the Commonwealth because of a reduction in the investor's license tax derived from the credit granted under this article.

§ 58.1-2551. Transferability of credit.

A. The Director, in consultation with the State Corporation Commission, shall adopt regulations to facilitate the transfer or assignment of license tax credits by participating investors. The regulations shall be exempt from the Administrative Process Act (§ 2.2-4000 et seq.).

B. A participating investor shall not transfer or assign, agree to transfer, or agree to sell or assign license tax credits until 180 days from the date on which the participating investor invested designated capital. After 180 days from the date of investment, a participating investor, or subsequent transferee, may transfer credits based upon rules adopted by the Director to facilitate such transfers.

C. Any tax credits recaptured under this article remain the liability of the participating investor that actually applied the credit towards its tax liability.

D. The transfer or assignment of a license tax credit does not affect the schedule for taking the license tax credit under this article.

§ 58.1-2552. Secrecy of information.

Notwithstanding any other provision of law, the Department of Business Assistance and the State Corporation Commission shall be authorized to share such information as is necessary to carry out the provisions of this article.

2. That the provisions of this act shall become effective on January 1, 2010.

3. That the insurance license tax credits provided in this act shall be paid from the portion of the license tax revenues that are deposited into the general fund of the state treasury.