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SENATE BILL NO. 733

Offered February 1, 2010

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 58.1-2551, relating to tax credits against the state license tax on certain insurance companies.*

Patrons—McWaters, Vogel, Blevins, Marsden, Martin, Norment, Obenshain, Puller and Reynolds;
Delegate: Armstrong

Introduced at the request of Governor

Referred to Committee on Finance

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 58.1-2551, 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 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 of a Virginia small business investment company are allocated designated capital by the Tax Commissioner under this article.

"Designated capital" means an investment of cash by a certified 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.

"Virginia small business investment company" means a partnership, corporation, or trust or limited liability company, whether organized on a profit or not-for-profit basis, that: 1) has its principal office located or is headquartered in Virginia; and 2) has as its primary business activity the investment of cash in qualified businesses and that is certified as meeting the criteria of this article.

"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.

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

"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

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

62 4. Has not more than 100 employees and:
63 a. Employs at least 80 percent of its employees in the Commonwealth; or
64 b. Pays 80 percent of its payroll to employees in the Commonwealth;

65 5. Is primarily engaged in:
66 a. Manufacturing, processing, or assembling products;
67 b. Conducting research and development; or
68 c. Providing services;

69 6. Is not primarily engaged in:
70 a. Retail sales;
71 b. Real estate development;
72 c. The business of insurance, banking, or lending; or
73 d. The provision of professional services provided by accountants, attorneys, or physicians and
74 7. Is not a franchise of and has no financial relationship with a Virginia small business investment
75 company or any affiliate of a Virginia small business investment company prior to a Virginia small
76 business investment company's first qualified investment in the business.

77 8. A business classified as a qualified business at the time of the first qualified investment in the
78 business will remain classified as a qualified business and may receive continuing qualified investments
79 from any Virginia small business investment company. Continuing investments will constitute qualified
80 investments even though the business may not meet the definition of a qualified business at the definition
81 of a qualified business at the time of such continuing investments.

82 "Qualified debt instrument" means a debt instrument issued by a Virginia small business investment
83 company, at par value or a premium, that:
84 1. Has an original maturity date of at least four years after the date of issuance;
85 2. Has a repayment schedule that is not faster than a level principal amortization over four years;
86 and
87 3. Has no interest or payment features that allow for the prepayment of interest or are tied to the
88 profitability of the Virginia small business investment company or the success of its investments.

89 "Qualified distribution" means any distribution or payment by a Virginia small business investment
90 company in connection with:
91 1. The reasonable costs and expenses of forming, syndicating, managing, and operating the company,
92 provided that the distribution or payment is not made directly or indirectly to a participating investor,
93 including:
94 a. Reasonable and necessary fees paid for professional services, including legal and accounting
95 services, related to the formation and operation of the company; and
96 b. An annual management fee in an amount that does not exceed two percent of the designated
97 capital of the company; and
98 2. Any projected increase in federal or state taxes, including penalties and interest related to state
99 and federal income taxes, or the equity owners of the company resulting from the earnings or other tax
100 liability of the company to the extent that the increase is related to the ownership, management, or
101 operation of the company.

102 "Qualified investment" means the investment of cash by a Virginia small business investment
103 company in a qualified business for the purchase of any debt, debt participation, equity, or hybrid
104 security of any nature or description, including a debt instrument or security that has the characteristics
105 of debt but that provides for conversion into equity or equity participation instruments such as options
106 or warrants.

107 "State license tax liability" means any liability incurred by any person under Article 1 (§ 58.1-2500
108 et seq.) of Chapter 25.

109 § 58.1-2533. Duties of Tax Commissioner; regulations.
110 The Tax Commissioner shall administer this article and may adopt regulations as necessary to
111 implement this article.

112 § 58.1-2534. Certification.
113 A. The Tax Commissioner shall establish the application procedures for Virginia small business
114 investment companies.
115 B. An applicant must file an application on the form prescribed by the Tax Commissioner
116 accompanied by a nonrefundable application fee of \$7,500. The application must include an audited
117 balance sheet of the applicant, with an unqualified opinion from an independent certified public
118 accountant, as of a date not more than 35 days before the date of the application.

119 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 Tax Commissioner.

D. The Tax Commissioner 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 Tax Commissioner 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 or other persons 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 Tax Commissioner. 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; 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.

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

181 company greater than 15 percent of the total designated capital of the company at the time of
182 investment.

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

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

189 1. Cash deposited with a federally insured financial institution;

190 2. Certificates of deposit in a federally insured financial institution;

191 3. Investment securities that are obligations of the United States or its agencies or instrumentalities
192 or obligations that are guaranteed fully as to principal and interest by the United States;

193 4. Debt instruments rated at least "A" or its equivalent by a nationally recognized credit rating
194 organization, or issued by, or guaranteed with respect to payment by, an entity whose unsecured
195 indebtedness is rated at least "A" or its equivalent by a nationally recognized credit rating organization,
196 and which indebtedness is not subordinated to other unsecured indebtedness of the issuer or the
197 guarantor;

198 5. Obligations of the Commonwealth or any political subdivision of the Commonwealth; or

199 6. Any other investments approved in advance and in writing by the Tax Commissioner.

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

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

207 § 58.1-2538. Evaluation of business by Tax Commissioner.

208 A. A Virginia small business investment company may, before making an investment in a business,
209 request from the Tax Commissioner a written opinion as to whether the business in which it proposes to
210 invest is a qualified business.

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

216 C. If the Tax Commissioner fails to notify the Virginia small business investment company with
217 respect to the proposed investment within the period specified by subsection B, the business in which the
218 company proposes to invest is considered to be a qualified business.

219 § 58.1-2539. Reports to Tax Commissioner; audited financial statement.

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

222 1. The name of each participating investor from whom the designated capital was received, including
223 the participating investor's insurance license tax identification number;

224 2. The amount of each certified investor's investment of designated capital and license tax credits;
225 and

226 3. The date on which the designated capital was received.

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

229 1. The amount of the company's designated capital at the end of the preceding year;

230 2. Whether or not the company has invested more than 15 percent of its total designated capital in
231 any one business without specific approval of the Tax Commissioner;

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

235 4. Any other information required by the Tax Commissioner.

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

240 1. The company is complying with this article;

241 2. The funds received by the company have been invested as required within the time provided by

242 § 58.1-2537; and

3. The company has invested the funds in qualified businesses.

§ 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 Tax Commissioner. 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.

§ 58.1-2542. Annual review; decertification.

A. The Tax Commissioner 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 Tax Commissioner.

C. A material violation is grounds for decertification of the Virginia small business investment company. If the Tax Commissioner determines that a company is not in compliance § 58.1-2537, 58.1-2539 or 58.1-2540, the Tax Commissioner 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 Tax Commissioner may decertify a Virginia small business investment company, after opportunity for hearing, if the Tax Commissioner finds that the company is not in compliance with § 58.1-2537, 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 Tax Commissioner shall notify any appropriate state agency of the decertification.

§ 58.1-2543. Administrative penalty.

A. The Tax Commissioner may impose an administrative penalty on a Virginia small business investment company that violates this article.

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

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

2. The economic harm caused by the violation;

3. The history of previous violations;

4. The amount necessary to deter a future violation;

5. Efforts to correct the violation; and

6. Any other matter that justice may require.

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

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

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

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

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

313 B. The Tax Commissioner shall send written notice to the address of each participating investor
314 whose license tax credit is subject to recapture or forfeiture, using the address shown on the last license
315 tax filing.

316 § 58.1-2545. Indemnity agreements and insurance authorized.

317 A Virginia small business investment company that agree to indemnify, or purchase insurance for the
318 benefit of, a investor for losses resulting from the recapture or forfeiture of license tax credits under
319 § 58.1-2544. Any guaranty, indemnity, bond, insurance policy, or other payment undertaking made under
320 this section may not be provided by more than one participating investor of the Virginia small business
321 investment company or affiliate of the participating investor.

322 § 58.1-2546. License tax credit.

323 A. A Virginia small business investment who makes an investment of designated capital shall in the
324 year of investment earn a vested credit against state license tax liability equal to 100 percent of the
325 participating investor's investment of designated capital, subject to the limits imposed by this article. A
326 participating investor may take up to 20 percent of the vested license tax credit in any taxable year
327 beginning on or after January 1, 2014.

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

331 C. A participating investor claiming a credit against state license tax liability earned through an
332 investment in a company is not required to pay any additional retaliatory tax levied under Chapter 25
333 (§ 58.1-2500 et seq.) as a result of claiming that credit.

334 § 58.1-2547. License tax credit allocation claim form.

335 A. A license tax credit allocation claim must be prepared and executed by a participating investor on
336 a form provided by the Tax Commissioner. The Virginia small business investment company must file
337 the claim with the Tax Commissioner. The license tax credit allocation claim form must include an
338 affidavit of the participating investor under which the participating investor becomes legally bound and
339 irrevocably committed to make an investment of designated capital in a Virginia small business
340 investment company in the amount allocated even if the amount allocated is less than the amount of the
341 claim, subject only to the receipt of an allocation under § 58.1-2549.

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

344 § 58.1-2548. Total limit on credits.

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

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

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

353 § 58.1-2549. Pro rata allocation of credits.

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

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

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

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

364 C. Not later than March 1 of each year, the Tax Commissioner shall notify each Virginia small
365 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 Tax Commissioner by overnight common carrier delivery service and that portion of capital allocated to the participating investor shall be forfeited. The Tax Commissioner 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 Tax Commissioner shall adopt regulations to facilitate the transfer or assignment of license tax credits by participating investors. 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 Tax Commissioner to facilitate such transfers.

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

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

2. That the provisions of this act shall become effective on January 1, 2011.