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HOUSE BILL NO. 1498

Offered January 22, 1996

A BILL to amend the Code of Virginia by adding in Title 59.1 a chapter numbered 22.3, consisting of sections numbered 59.1-284.13 through 59.1-284.14, relating to the Virginia Capital Company Act.

Patrons—Scott, Albo, Callahan, Diamonstein, Keating and O'Brien; Senators: Houck, Howell and Ticer

Referred to Committee on Corporations, Insurance and Banking

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Title 59.1 a chapter numbered 22.3, consisting of sections numbered 59.1-284.13 through 59.1-284.25 as follows:

CHAPTER 22.3.**THE VIRGINIA CAPITAL COMPANY ACT.**

§ 59.1-284.13. Definitions.

As used in this chapter:

"Capital lease" means a lease meeting one or more of the following criteria:

1. The lease transfers ownership of the property to the lessee at the end of the lease term by the lessee's exercise of a purchase option which is de minimis in amount;

2. The lease term is equal to seventy-five percent or more of the estimated economic life of the leased property. However, if the beginning of the lease term falls within the last twenty-five percent of the total estimated economic life of the leased property, including earlier years of use, this criterion shall not be used;

3. Under generally accepted accounting principles, the lessee cannot treat payments to the capital company as payments under an operating lease; or

4. For federal income tax purposes, the parties are required to treat payments as amortization of principal and interest.

"Department" means the Department of Economic Development.

"Qualified investment" means a debt, equity or capital lease financing of a business which (i) has annual gross revenues of no more than ten million dollars, (ii) is domiciled in the Commonwealth of Virginia, and (iii) is engaged in business primarily in or does substantially all of its production in the Commonwealth. The investment by a Virginia Capital Company in purchase of property to be leased by it, as lessor, through a capital lease is a qualified lease.

"Qualified Virginia capital company" means a Virginia capital company that has been designated by the Department of Economic Development as qualified under the provisions of section 59.1-284. 14 of this section.

"Virginia capital company" means any of the following entities that was created for the purpose of making venture or risk capital available to qualified investments and that has been certified by the Commission.

1. A Virginia stock corporation organized pursuant to Chapter 9 (§ 13.1-601 et seq.) of Title 13.1;

2. A Virginia nonstock corporation organized pursuant to Chapter 1 (§ 50-1 et seq.) of Title 50;

3. A partnership organized pursuant to Chapter 1 (§ 50-1 et seq.) of Title 50;

4. A limited liability company organized pursuant to Chapter 12 (§ 13.1-1000) of Title 13.1; or

5. A foreign entity with its principal place of business in the Commonwealth and which is issued a certificate of authority by the Commonwealth to do business within the Commonwealth pursuant to § 13.1-759.

§ 59.1-284.14. Application to the Department of Economic Development; qualification of Virginia capital companies.

A. A Virginia capital company seeking to be qualified shall make application to the Department of Economic Development on forms provided therefor, setting forth the following:

1. Capitalization level of the Virginia capital company;

2. Purpose of the Virginia capital company;

3. Names of the Virginia capital company's investors;

4. A process for disclosing to investors the tax credit available pursuant to this chapter. Such disclosure shall clearly set forth that no tax credit will be available until the qualification of the Virginia capital company by the Department and disclosure of immunity of the Commonwealth for damages to such investors;

5. The location of an escrow account, established in the Commonwealth, into which account funds invested in the applicant shall be deposited and held for the period of time between the receipt of the

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60 investment by the applicant and the qualification of the Virginia capital company by the Department.
61 Such funds shall not be invested by the applicant until such designation by the Department. If the
62 Virginia capital company is not qualified, such funds shall be returned to the investors, if requested by
63 the investors.

64 B. Commencing July 1, 1996, the Department shall qualify Virginia capital companies in existence
65 after such date.

66 C. A Virginia capital company may not qualify or be issued a certification under this chapter unless
67 the company holds a valid business license issued pursuant to the applicable statutes and local
68 ordinances. A company exempt from license may qualify and be certified upon proof of its exemption.
69 § 59.1-284.15. Minimum standards of qualified Virginia capital companies.

70 A "qualified Virginia capital company" shall satisfy the following criteria:

71 1. A qualified Virginia capital company shall be a Virginia capital company that has been
72 designated by the Department as qualified under the provisions of § 59.1-284.14 of this section;

73 2. A qualified Virginia capital company shall have a reasonably accessible business office located
74 within the Commonwealth, a listed telephone number, and be open to the public during normal business
75 hours;

76 3. A qualified Virginia capital company shall maintain all of its capital base, except that which has
77 been invested to meet the purposes of this section, in bank accounts and financial institutions which are
78 located in the Commonwealth, or in such other interest-bearing instruments with a maturity of less than
79 one year which are obtained from and managed by a financial institution located in the Commonwealth;

80 4. A qualified Virginia capital company shall have a capital base of at least two million dollars, but
81 not greater than five million dollars, which capital base must be raised after July 1, 1996. If the amount
82 of the investment in the capital base of a qualified company exceeds five million dollars, such amount in
83 excess of five million dollars is not eligible for tax credits under this section;

84 5. No more than twenty-five percent of each separate capital base of a qualified Virginia capital
85 company shall be in the form of full recourse, interest bearing demand notes, backed by an irrevocable
86 letter of credit or bond from a reputable source, as determined by the Department;

87 6. A qualified Virginia capital company's stated purpose shall be to encourage and assist in the
88 creation, development or expansion of businesses in the Commonwealth;

89 7. A qualified Virginia capital company, seeking to establish a separate capital base, or increase its
90 capital base, shall establish an escrow account located in the Commonwealth, into which it shall deposit
91 account funds invested in the qualified Virginia capital company and it shall hold such funds for the
92 period of time between their receipt by the qualified company and the designation as qualified of a
93 separate capital base or an increase to the capital base. Such funds shall not be invested by the
94 qualified Virginia capital company until such designation by the Department. If the Department does not
95 designate as qualified a separate capital base or an increase to capital base, such funds shall be
96 returned to the investors, if requested by the investors;

97 8. A qualified Virginia capital company, when soliciting funds for its capital base, must disclose that
98 no tax credit for the investor's investment will be available until the Department designates as qualified
99 a capital base or an increase to capital base and issues to the qualified Virginia capital company notice
100 of such qualification and a certificate of tax credit.

101 § 59.1-284.16 . Tax credit for investment in Virginia capital companies.

102 A. For taxable years beginning on and after January 1, 1996, a taxpayer shall be allowed a credit
103 against the taxes imposed by Articles 2 (§ 58.1-320 et seq.), 6 (§ 58.1-360 et seq.), and 10 (§ 58.1-400
104 et seq.) of Chapter 3; Chapter 12 (§ 58.1-1200 et seq.); Article 1 (§ 58.1-2500 et seq.) of Chapter 25;
105 or Article 2 (§ 58.1-2620 et seq.) of Chapter 26 of this title, in an amount equal to fifty percent of its
106 investment in a qualified Virginia capital company.

107 B. For purposes of this section, the amount of any credit attributable to a partnership, electing small
108 business corporation (S corporation), or limited liability company shall be allocated to the individual
109 partners, shareholders, or members, respectively, in proportion to their ownership or interest in such
110 business entities.

111 C. The total amount of tax credits authorized for a single qualified Virginia capital company may
112 not exceed \$2.5 million. The Department may increase the capitalization of the company.

113 D. The total amount of tax credits available under this section for all qualified Virginia capital
114 companies may not exceed twenty-five million dollars

115 E. The tax credit allowed under this section shall be taken after all other credits allowed by law.

116 F. The amount of credit allowed pursuant to this section shall not exceed the tax imposed for such
117 taxable year. Any credit not usable for the taxable year the credit was allowed may be, to the extent
118 usable, carried over for the next fifteen succeeding taxable years. No credit shall be carried back to a
119 preceding taxable year.

120 G. The tax credit allowed under this section is available only to those taxpayers who invest in a
121 qualified Virginia capital company after July 1, 1996.

H. The tax credit allowed under this section shall not be used against any taxpayer liability for interest, penalties or additions to tax.

I. A taxpayer receiving a tax credit under the provisions of this section shall not be subject to a recapture provision for any credit claimed; however, the qualified Virginia capital company may be subject to the civil penalty provision provided in § 59.1-284.17.

§ 59.1-284.17. Qualified investments; liquidation or dissolution; penalty.

A. A qualified Virginia capital company must use its capital base to make qualified investments according to the following schedule:

1. At least twenty-five percent of its capital base within the first year of the date on which the qualified Virginia capital company was designated as qualified by the Department;

2. At least fifty percent of its capital base within two years of the date on which the qualified Virginia capital company was designated as qualified by the Department; and

3. At least seventy-five percent of its capital base within three years of the date on which the qualified Virginia capital company was designated as qualified by the Department.

B. A qualified Virginia capital company shall maintain its qualified investments for a period of at least five years, except that a qualified Virginia capital company receiving repayment or return of a qualified investment (exclusive of interest, dividends or other earnings on such investment) shall reinvest the qualified Virginia capital company's repaid or returned cost basis in the investment in a qualified investment which remains outstanding for a period of time at least equal to the remainder of the initial five-year term, such reinvestment to be made within twenty-four months from the date of repayment or return, unless a waiver is obtained from the Department prior to the end of such twenty-four-month period; provided, that such returned amounts may be accumulated for six months before the twenty-four-month period commences.

C. A qualified Virginia capital company may be dissolved or liquidated only after notice and approval of such dissolution or liquidation by the Department. The Department shall provide by regulation a procedure for application for approval to dissolve or liquidate a qualified Virginia capital company and such approval shall not be unreasonably withheld. Unless waived by the Department, no dissolution or liquidation of any qualified Virginia capital company may be made if such dissolution or liquidation would cause the provisions of subsection B of this section to be violated.

D. The Department shall periodically audit the certified audit of each qualified Virginia capital company, as required by § 59.1-284.21 of this chapter, and the results of such audit shall be used to notify the Tax Commissioner of any qualified Virginia capital company that are not in compliance with this section.

E. A qualified Virginia capital company that fails to make or maintain qualified investments pursuant to this section shall pay to the Tax Commissioner a penalty equal to all of the tax credits allowed to the taxpayers investing in such qualified Virginia capital company with interest at the rate of one percent per month, compounded monthly, from the date the tax credits were certified by the Commissioner as allocated to the qualified Virginia capital company. The Commissioner may abate such penalty upon written request if the qualified Virginia capital company establishes reasonable cause for the failure to make qualified investments. The Commissioner shall deposit any amounts received under this subsection in the general fund of the Commonwealth.

§ 59.1-284.18. Restrictions on investment.

A. No more than thirty percent of the capital base raised by a qualified Virginia capital company under this chapter may be invested in any one business.

B. No portion of the capital base of a qualified Virginia capital company may be invested in a business that is the "alter ego" of the qualified Virginia capital company. For purposes of this section, a business is an "alter ego" of the qualified Virginia capital company if any either of the following criteria are satisfied: (i) the ownership of the business is substantially related to the ownership of the capital company or (ii) the management of the business is controlled by the qualified Virginia capital company.

C. No owner, director, officer or employee of a qualified Virginia capital company may occupy any management position in any business in which the qualified Virginia capital company has invested, unless such person is filling the management position in an effort to remedy problems arising from a lack of profitability of the business or from negligence or dishonesty of the persons otherwise managing the business.

D. A qualified Virginia capital company may not invest any of its capital base in any of the following businesses:

1. Banks;
2. Savings and loan institutions;
3. Credit companies;
4. Financial, broker or investment companies;

183 5. Businesses organized for the primary purpose of rendering professional services as defined in
184 Chapter 7 (§ 13.1-542 et seq.) of Title 13.1;

185 6. Accounting companies;

186 7. Other Virginia capital companies;

187 8. Charitable and religious institutions;

188 9. Conventional coal, oil and gas and mineral exploration companies;

189 10. Insurance companies;

190 11. Residential housing or real estate development companies; or

191 12. Any other business which the Department determines by regulation to be against the public
192 interest, the purposes of this chapter or in violation of law.

193 § 59.1-284.19. Conflict of interests.

194 No officer, member or employee of the Department shall be financially interested, directly or
195 indirectly, in any qualified Virginia capital company.

196 § 59.1-284.20. Investment reporting and record-keeping.

197 A. Each qualified Virginia capital company shall report, at a minimum, to the Tax Commissioner
198 and the Department on an annual basis, or otherwise, as established by regulation of the Department.

199 B. A qualified Virginia capital company shall provide each investor in the qualified Virginia capital
200 company with a copy of the certificate issued by the Department authorizing the tax credits, and a true
201 copy of the certificate shall be submitted with each taxpayer's tax return claiming a credit under
202 § 59.1-284.16.

203 § 59.1-284.21. Examination of books and records.

204 A. Each qualified Virginia capital company shall annually cause its books and records to be
205 financially audited by an independent certified public accountant in accordance with generally accepted
206 accounting principles. The audit shall also address the methods of operation and conduct of the business
207 of the qualified Virginia capital company to determine its compliance with the provisions of this chapter
208 and that the funds received by the qualified Virginia capital company have been invested within the time
209 limits required by § 59.1-284.17. Upon completion, a copy of the audit report shall be certified and sent
210 to the Department.

211 B. The Department may conduct interviews with any of the officers, directors, agents, employees or
212 investors of a qualified Virginia capital company regarding the affairs and business of the qualified
213 Virginia capital company. If a qualified Virginia capital company fails to comply with the requests of
214 the Department, the Department may petition the circuit court of the county in which the qualified
215 Virginia capital company is located to issue a subpoena or subpoena duces tecum and enforce
216 compliance with such subpoena or subpoena duces tecum.

217 C. The Department and the Tax Commissioner may also jointly audit any qualified Virginia capital
218 company in any year on a random basis, or for cause, or for any other basis the Department of Tax
219 Commissioner may select. The Tax Commissioner may also audit any company or business in which a
220 qualified Virginia capital company has made an investment, or which a qualified Virginia capital
221 company proposes to invest, on a random basis, or for cause, or for any other basis the Tax
222 Commissioner may select. Nothing herein shall be construed to prohibit the Tax Commissioner from
223 conducting any audit relating to the administration or enforcement of the tax laws of the Commonwealth
224 which the Tax Commissioner, in his discretion, determines to be appropriate.

225 § 59.1-284.22. Failure to comply with requests for information.

226 A. If it is determined, pursuant to an examination conducted under § 59.1-284.21, that a qualified
227 Virginia capital company is not in compliance with the provisions of this chapter, the Department may
228 exercise any of the powers necessary and appropriate to protect the Department's interest.

229 B. The Department shall give a qualified Virginia capital company written notice of any
230 inadequacies in its compliance with the provisions of this chapter, and specify a period of time the
231 company has to redress such inadequacies. Failure to address such inadequacies within such time
232 period will result in further action by the Department, including removal of the qualification
233 designation.

234 § 59.1-284.23. Limitation on financial institutions.

235 Not more than forty-nine percent of the total capital base of any qualified Virginia capital company
236 may be owned by banks, savings and loan associations, savings banks or other financial institutions, or
237 any affiliate thereof, as investors. No officer or director of any such financial institution may serve in
238 the management of any qualified Virginia capital company organized under the provisions of this
239 chapter.

240 § 59.1-284.24. Confidentiality.

241 A. The Department shall determine which records, reports or information obtained from any person
242 or entity under this chapter are to be treated by the agency as confidential and not subject to
243 disclosure, except as hereinafter provided in subsection C of this section. Notwithstanding any other
244 provision of law, the Department shall make available to the public the name of any business or

company receiving a qualified investment from a qualified Virginia capital company and the name of the capital company making the investment.

B. Any other records, reports, or information obtained from any person or entity under this chapter shall be made available to the public, except that upon satisfactory showing to the Department by any person or entity at the time of submission that records, reports or information to which the Department or its officers, employees or representatives has or will have access to under this section is entitled to protection under § 1905 of Title 18 of the United States Code, then such information is confidential in accordance with the purposes of this section. In submitting data under the provisions of this chapter, a person required to provide such information may designate the information which he believes is entitled to protection under this subsection and submit such information separately from other information submitted. A designation under this subsection shall be made in writing and in such a manner as the Department may prescribe.

C. Any record, report, document, or information may disclosed to other officers, employees, or authorized representatives of the Commonwealth charged with the administering the provisions of this chapter and may be disclosed pursuant to the provision of subsection B of this section.

D. Notwithstanding any provision of this section, the Tax Commissioner, its agents and employees remain subject to the confidentiality provisions of Title 58.1 regarding the disclosure of tax returns and tax information.

§ 59.1-284.25. Rules and regulations.

Rules and regulations prescribing procedures effectuating the purpose of this chapter shall be promulgated by the Department of Economic Development in accordance with the Administrative Process Act (§ 9-6.14:1 et seq.).