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HOUSE BILL NO. 2645

Offered January 20, 1997

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 59.1-284.26, relating to the Virginia Capital Formation Act.

Patrons—Scott, Almand, Bennett, Callahan, Cantor, Darner, Guest, Hall, Hargrove, Hull, Keating, Lovelace, May, McClure, Moran, O'Brien, Plum, Puller and Shuler; Senators: Barry, Gartlan, Howell, Saslaw and Stosch

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 59.1-284.26, as follows:

CHAPTER 22.3.**THE VIRGINIA CAPITAL FORMATION ACT.****§ 59.1-284.13. Definitions.**

As used in this chapter:

"Authority" means the Virginia Economic Development Partnership.

"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.

"Equity" means common stock or preferred stock, regardless of class or series, of a corporation; a partnership interest in a limited partnership; or a membership interest in a limited liability company, which is not required or subject to an option on the part of the taxpayer to be redeemed by the issuer within five years from the date of issuance.

An "equity investment" shall not be qualified if the taxpayer who holds such investment, or any of such taxpayer's family members, or any corporation or other entity affiliated with such taxpayer, receives compensation from the issuer of the investment in exchange for services provided to the issuer as an employee, officer, director, manager, independent contractor or otherwise; however, reimbursement of reasonable expenses incurred shall not be deemed to be compensation.

A taxpayer shall be deemed to have made a qualified equity to the extent of the cash provided in exchange for such investment.

"Qualified investment" means a subordinated debt, equity or capital lease financing of a business which (i) has annual gross revenues of no more than five million dollars in its most recent fiscal year, (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.

A qualified investment shall not be made in any of the following businesses:

1. Banks;

2. Savings and loan institutions;

3. Credit companies;

4. Financial, broker or investment companies;

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

6. Accounting companies;

7. Other Virginia capital companies;

8. Charitable and religious institutions;

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

10. Insurance companies;

11. Construction or construction contracting companies;

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60 12. Business consulting or business brokering companies;
61 13. Residential housing or real estate development companies; or
62 14. Any other business which the Authority determines by regulation to be against the public interest,
63 the purposes of this chapter or in violation of law.

64 "Qualified Virginia capital company" means a Virginia capital company that has been designated by
65 the Virginia Economic Development Partnership as qualified under the provisions of § 59.1-284.14.

66 "Subordinated debt investment" means indebtedness of a corporation, general or limited partnership,
67 or limited liability company that (i) by its terms requires no repayment of principal for the first three
68 years after issuance; (ii) is not guaranteed by any other person or secured by any assets of the issuer or
69 any other person; and (iii) is subordinated to all indebtedness and obligations of the issuer to
70 national- or state-chartered banking or savings and loan institutions.

71 A subordinated debt investment shall not be qualified if the taxpayer who holds such investment, or
72 any of such taxpayer's family members, or any corporation or other entity affiliated with such taxpayer,
73 receives compensation from the issuer of the investment in exchange for services provided to the issuer
74 as an employee, officer, director, manager, independent contractor or otherwise; however,
75 reimbursement of reasonable expenses incurred shall not be deemed to be compensation.

76 A taxpayer shall be deemed to have made a qualified subordinated debt investment to the extent of
77 the cash provided in exchange for such investment.

78 "Virginia capital company" means any of the following entities that are created for the purpose of
79 making venture or risk capital available to qualified investments and that are certified by the State
80 Corporation Commission:

- 81 1. A Virginia stock corporation organized pursuant to Chapter 9 (§ 13.1-601 et seq.) of Title 13.1;
- 82 2. A Virginia nonstock corporation organized pursuant to Chapter 10 (§ 13.1-801 et seq.) of Title
83 13.1;
- 84 3. A partnership organized pursuant to Chapter 1 (§ 50-1 et seq.) of Title 50;
- 85 4. A limited liability company organized pursuant to Chapter 12 (§ 13.1-1000) of Title 13.1; and
- 86 5. A foreign entity with its principal place of business in the Commonwealth and which has been
87 issued a certificate of authority by the Commonwealth to do business within the Commonwealth
88 pursuant to § 13.1-759.

89 § 59.1-284.14. Application to the Virginia Economic Development Partnership; qualification of
90 Virginia capital companies.

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

- 93 1. Its capitalization level;
- 94 2. Its purpose;
- 95 3. The names its investors;
- 96 4. A process for disclosing to investors the tax credit available pursuant to this chapter. Such
97 disclosure shall clearly set forth that no tax credit will be available until the qualification of the
98 Virginia capital company by the Authority and the disclosure of immunity of the Commonwealth for
99 damages to such investors;

100 5. The location of an escrow account, established in the Commonwealth, into which account funds
101 invested in the applicant shall be deposited and held for the period of time between the receipt of the
102 investment by the applicant and the qualification of the Virginia capital company by the Authority. Such
103 funds shall not be invested by the applicant until such designation by the Authority. If the Virginia
104 capital company is not qualified, such funds shall be returned to the investors, if requested by the
105 investors.

106 B. On and after July 1, 1997, if a company satisfies the requirements of and is approved by the
107 Authority, it shall be qualified and issued a certification as a Virginia capital company.

108 C. A Virginia capital company may not be qualified or be certified under this chapter unless the
109 company holds a valid business license issued pursuant to the applicable statutes and local ordinances.
110 A company exempt from licensure may qualify and be certified upon proof of its exemption.

111 § 59.1-284.15. Minimum standards of qualified Virginia capital companies.

112 A qualified Virginia capital company shall satisfy the following criteria:

- 113 1. Be a Virginia capital company that has been designated by the Authority as qualified under the
114 provisions of § 59.1-284.14;
- 115 2. Have a reasonably accessible business office located within the Commonwealth and a listed
116 telephone number, and be open to the public during normal business hours;
- 117 3. Maintain all of its capital base, except that which has been invested to meet the purposes of this
118 section, in bank accounts and financial institutions which are located in the Commonwealth, or in such
119 other interest-bearing instruments with a maturity of less than one year which are obtained from and
120 managed by a financial institution located in the Commonwealth;
- 121 4. Have a capital base of at least two million dollars, but not greater than five million dollars, which

investments in the capital base shall be raised on or after July 1, 1997. If the amount of the investment in the capital base of a qualified company exceeds five million dollars, such amount in excess of five million dollars is not eligible for tax credits under this section;

5. Maintain no more than twenty-five percent of each separate capital base in the form of full recourse, interest-bearing demand notes, backed by an irrevocable letter of credit or bond from a reputable source, as determined by the Authority;

6. Have a stated purpose to encourage and assist in the creation, development or expansion of businesses in the Commonwealth;

7. When seeking to establish a separate capital base or increase its capital base, establish an escrow account located in the Commonwealth into which it shall deposit account funds invested in the qualified Virginia capital company, and hold such funds for the period of time between their receipt and their designation as qualified, a separate capital base or an increase to the capital base. Such funds shall not be invested by the qualified Virginia capital company until such designation by the Authority. If the Authority does not approve such designation, the funds shall be returned to the investors, if requested by the investors;

8. When soliciting funds for its capital base, disclose that no tax credit for the investor will be available until the Authority designates as qualified a capital base or an increase to capital base and issues to such company notice of the qualification and a certificate of tax credit.

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

A. For taxable years beginning on and after January 1, 1997, a taxpayer shall be allowed a credit against the taxes imposed by §§ 58.1-320, 58.1-360, 58.1-400, 58.1-1202, 58.1-2501, 58.1-2620, in an amount equal to fifty percent of its investment in a qualified Virginia capital company.

B. For purposes of this section, the amount of any credit attributable to a partnership, electing small business corporation (S corporation), or limited liability company shall be allocated to the individual investors pursuant to an agreement of the partners, shareholders, or members, as the case may be.

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

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

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

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

G. The tax credit allowed under this section is available only to those taxpayers who invest in a qualified Virginia capital company after July 1, 1997.

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 provided in § 59.1-284.17.

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

A. A qualified Virginia capital company shall 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 it was qualified;

2. At least fifty percent of its capital base within two years of its qualification date; and

3. At least seventy-five percent of its capital base within three years of such qualification.

B. A qualified Virginia capital company shall maintain its qualified investments for a period of at least five years from the date of investment, except that such company receiving a repayment or the return of a qualified investment (exclusive of interest, dividends or other earnings on such investment) shall reinvest such company's repayment or return in a qualified investment which remains outstanding for a period at least equal to the remainder of the initial five-year term. Such reinvestment shall be made within twenty-four months from the date of repayment or return, unless a waiver is obtained from the Authority prior to the end of such period; however, the 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 Authority. The Authority shall provide by regulation a procedure for the dissolution or liquidation of a qualified Virginia capital company, and approval shall not be unreasonably withheld. Unless waived by the Authority, no dissolution or liquidation of any qualified Virginia capital company may be made if such dissolution or liquidation would cause the

183 provisions of subsection B to be violated.

184 D. The Authority periodically shall audit the certified audit of each qualified Virginia capital
185 company, as required by § 59.1-284.21, and the results of such audit shall be used to notify the Tax
186 Commissioner if the qualified Virginia capital company is not in compliance with this section.

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

195 § 59.1-284.18. Restrictions on investment.

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

198 B. No portion of the capital base of a qualified Virginia capital company shall be invested in a
199 business that is an affiliate of such qualified Virginia capital company. For purposes of this section,
200 "affiliate" means a person or entity that directly or indirectly, through one or more intermediaries,
201 controls, is controlled by, or is under common control with the person or entity specified.

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

207 D. A qualified Virginia capital company shall only invest its capital base in qualified investments.

208 § 59.1-284.19. Conflicts of interest.

209 No officer, member or employee of the Authority shall be financially interested, directly or indirectly,
210 in any qualified Virginia capital company.

211 § 59.1-284.20. Investment reporting and record keeping.

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

214 B. A qualified Virginia capital company shall provide each investor in the qualified Virginia capital
215 company with a copy of the certificate issued by the Authority authorizing the tax credits, and a true
216 copy of the certificate shall be submitted with each taxpayer's tax return claiming a credit under
217 § 59.1-284.16.

218 § 59.1-284.21. Examination of books and records.

219 A. Each qualified Virginia capital company shall annually cause its books and records to be
220 financially audited by an independent certified public accountant in accordance with generally accepted
221 accounting principles. The audit shall also address the methods of operation and conduct of the business
222 of the qualified Virginia capital company to determine if it complies with the provisions of this chapter
223 and if the funds received by such company have been invested within the time limits required by
224 § 59.1-284.17. Upon completion, a copy of the audit report shall be certified and sent to the Authority.

225 B. The Authority may conduct interviews with any of the officers, directors, agents, employees or
226 investors of a qualified Virginia capital company regarding the affairs and business of such company. If
227 a qualified Virginia capital company fails to comply with the requests of the Authority, the Authority
228 may petition the circuit court of the county in which the qualified Virginia capital company is located to
229 issue a subpoena or subpoena duces tecum and enforce compliance with such subpoena or subpoena
230 duces tecum.

231 C. The Authority and the Tax Commissioner may also jointly audit any qualified Virginia capital
232 company in any year on a random basis, or for cause, or on any other basis the Authority or Tax
233 Commissioner may select. The Tax Commissioner may also audit, on a random basis, or for cause, or
234 for any other basis the Tax Commissioner may select, any company or business in which a qualified
235 Virginia capital company has made an investment, or which a qualified Virginia capital company
236 proposes to invest. Nothing herein shall be construed to prohibit the Tax Commissioner from conducting
237 any audit relating to the administration or enforcement of the tax laws of the Commonwealth which the
238 Tax Commissioner determines to be appropriate.

239 § 59.1-284.22. Noncompliance; failure to address.

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

243 B. The Authority shall give a qualified Virginia capital company written notice of any inadequacies
244 in its compliance with the provisions of this chapter, and specify a period of time the company has to

redress such inadequacies. Failure to address such inadequacies within such time period will result in further action by the Authority, including removal of the qualification designation.

§ 59.1-284.23. Limitation on financial institutions.

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

§ 59.1-284.24. Confidentiality.

A. The Authority shall determine which records, reports or information obtained from any person or entity under this chapter are to be treated by the agency as confidential and not subject to disclosure, except as provided in subsection C. Notwithstanding any other provision of law, the Authority 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 under this chapter shall be made available to the public; however, upon satisfactory evidence to the Authority by person at the time of submission that such records, reports or information to which the Authority or its officers, employees or representatives have or will have access to under this section are entitled to protection under § 1905 of Title 18 of the United States Code, then such information shall be 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 that he believes is entitled to protection under this subsection and submit such information separately from any other information submitted. A designation under this subsection shall be made in writing and in such a manner as the Authority may prescribe.

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

D. Notwithstanding any provision of this section, the Tax Commissioner, his 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. Tax credit for qualified equity and subordinated debt investments.

A. For taxable years beginning on or after January 1, 1997, a taxpayer shall be allowed a credit against the tax levied pursuant to §§ 58.1-320, 58.1-360, 58.1-400, 58.1-1202, 58.1-2501 and 58.1-2620 in an amount equal to twenty-five percent of such taxpayer's qualified equity investment.

B. The amount of any credit attributable to a partnership, electing small business corporation (S corporation), or limited liability company shall be allocated to the individual partners, shareholders, or members, as the case may be.

C. An individual taxpayer seeking the tax credit provided by this section shall make application to the Authority on forms provide therefor. The Authority shall certify that a taxpayer claiming the credit has made a qualified investment; no such credit may be claimed unless the certification has been obtained. The Authority may require that a taxpayer requesting certification submit records and other documents indicating that the requirements of this section and applicable regulations have been satisfied.

D. A taxpayer's failure to hold a qualified equity investment for at least five years shall result in the forfeiture of both used and unused tax credits, unless the taxpayer transfers the investment as a result of the liquidation of the issuer; the merger, consolidation or other acquisition of the issuer by a party not affiliated with the issuer; or the death or liquidation of the taxpayer.

E. The aggregate amount of the credit for each taxpayer shall not exceed the lesser of (i) the tax imposed for such taxable year or (ii) \$25,000. Any credit not usable for the taxable year in which the credit was allowed may be, to the extent usable, carried over for the next fifteen succeeding taxable years until the total amount of the tax credit has been taken.

F. The amount of tax credits available under this section for a fiscal year shall be five million dollars.

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

§ 59.1-284.26. Rules and regulations.

Rules and regulations prescribing procedures effectuating the purpose of this chapter shall be

306 *promulgated by the Virginia Economic Development Partnership in accordance with the Administrative*
307 *Process Act (§ 9-6.14:1 et seq.).*