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SBT TAX CREDITS FOR INSURERS: CERTIFIED CAPITAL INVESTMENTS

House Bill 5477
Sponsor: Rep. Andrew Raczkowski
Committee: Insurance and Financial Services

Complete to 3-21-00

A SUMMARY OF HOUSE BILL 5477 AS INTRODUCED 3-7-00

The bill would create a new act under which single business tax (SBT) credits would be available to a "certified investor" (defined as an insurance company) investing in a "certified capital company" that provided capital to one or more small businesses headquartered and principally operating in Michigan (referred to as "qualified businesses"). The act would be administered by the Office of Financial and Insurance Services, which would have the authority to promulgate rules.

Under the bill, a certified investor (an insurance company) who made an investment of certified capital in a certified capital company would, at the time of investment, earn a vested credit against SBT liability equal to 100 percent of the investment of certified capital. An investor would be entitled to take up to 10 percent of the vested tax credit in any tax year beginning with the tax year during which the investment was made. A credit could not exceed tax liability in any tax year, but unused credits could be carried forward. An investor claiming an SBT credit could not as a result be required to pay any additional retaliatory tax under the Insurance Code. A tax credit could be transferred or sold to another certified investor. The bill would limit the total amount of credits for all taxpayers to $200 million. [The term "certified capital" would be defined to mean an investment of cash by a certified investor in a certified capital company which fully funds the purchase price of either 1) an equity interest in the company or 2) a qualified debt instrument.]

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

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

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

Tax Credit Allocations. A certified investor/insurance company would make a "tax credit allocation claim" to the Office of Financial and Insurance Services on a form provided by the office; the claim would include the statement that the investor was legally bound and irrevocably committed to make an investment of a specified amount of certified capital in a certified capital company. Credits would be allocated in the order that claims were received by the office. If total claims exceeded the amount of credits available, credits would be allocated on a pro rata basis. Within ten days of receiving a claim, the office would have to notify the investor of the amount of tax credits allocated to that investor. If an investor did not invest capital in a certified capital company within 10 business days after receiving an allocation, the certified investor would forfeit that portion of the allocation not invested and the forfeited amounts would be reallocated.

Investments by capital companies. The bill would require that a certified capital company invest at least 30 percent of its certified capital within three years after its allocation date and at least 50 percent of its certified capital within five years after its allocation date. No qualified investment could be made at a cost greater than 15 percent of the total certified capital of the company at the time of the investment. Before making an investment in a business, the company could request a written opinion from the Office of Financial and Insurance Services as to whether the company was a qualified business. The office would have to provide its opinion within ten days. If it failed to respond within that time, the business in question would be considered a qualified business. The office, as mentioned earlier, could determine that a business was a qualified business even if it did not meet the definition if the office determined that an investment in the business by a certified

capital company would further economic development in the state. Once a company had invested 100 percent of its capital, it would no longer be subject to the act and could no longer be decertified or have any tax credits recaptured. (The term "qualified investment" would mean the investment of cash by a certified capital company in a qualified business for the purchase of any debt, equity, or hybrid security, of any nature and description.)

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

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

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

Recapture of tax credits. Decertification of a company within three years after certification would cause the recapture of all tax credits previously claimed and the forfeiture of future credits to be claimed by certified investors. In the case of a company that failed to meet the requirement that 50 percent of capital be invested within five years, tax credits taken within the first three years would not be subject to recapture or forfeiture, but tax credits after the first three years would be. If a company was decertified after having met the three-year and five-year investment requirements, tax credits taken or due to be taken for the first five years after the allocation date would not be subject to recapture or forfeiture. Tax credits available to be taken after the fifth year would be subject to forfeiture only if the company was decertified within five years after its allocation date.

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