

**MICHIGAN EARLY STAGE VENTURE
CAPITAL INVESTMENT ACT**

House Bill 5320 as introduced
Sponsor: Rep. Scott Shackleton

House Bill 5321 (Substitute H-1)
Sponsor: Rep. Chris Ward

House Bill 5322 as introduced
Sponsor: Rep. Fran Amos

Committee: Commerce
Complete to 12-3-03

**A SUMMARY OF HOUSE BILLS 5320-5322 AS REPORTED FROM THE HOUSE
COMMITTEE ON COMMERCE 12-3-03**

House Bill 5321 would create the Michigan Early Stage Venture Capital Investment Act of 2003 to require that, within one year after the bill's effective date, the Michigan Early Stage Venture Capital Investment Corporation be established and a board appointed, a fund manager hired, an investment plan established, and funds solicited and made available for investment consistent with the investment plan. The corporation would have to create the Michigan Early Stage Venture Capital Investment Fund. Money in the fund could be invested in venture capital companies to promote investment in qualified businesses.

If the fund could not repay the negotiated return on a person's investment, the corporation would have to give the investor a certificate for a single business tax (SBT) or income tax credit for the difference between the amount repaid by the fund and the negotiated repayment amount. The credit would be a debt of the fund to the Department of Treasury. The fund would expire on January 1, 2054, and its balance would be transferred to the state's General Fund.

House Bill 5321 would define "venture capital company" as a corporation, partnership, or other legal entity whose primary business activity was the investment of equity capital in businesses that focus on areas including, but not limited to, alternative energy technology, high-technology activity, or health care. "Qualified business" would mean a seed or early stage business that was located in Michigan, that had its corporate headquarters in Michigan, or the majority of whose employees worked a majority of their time at a site located in Michigan. "Seed or early stage business" would mean a business that had less than \$10 million in gross receipts and fewer than 100 employees for the calendar year immediately preceding initial investment in the business by a venture capital company.

House Bill 5321 also contains a list of findings and purposes and contains a justificatory enacting section (all of which are described later).

House Bill 5320 would amend the Single Business Tax Act (MCL 208.37e) to specify that, for tax years beginning after 2008 and before 2020, a taxpayer that was an “investor” in the newly created fund could claim an SBT credit equal to the amount determined and certified under House Bill 5321. For tax years beginning after 2009, if a credit against the SBT or a successor tax were not allowed, the taxpayer could transfer the credit to a person who could claim an income tax credit (under House Bill 5322). The total amount of all certified SBT credits for all taxpayers for all years could not exceed \$150 million. The total amount of all credits authorized for any one year could not exceed \$30 million.

The term “investor” is defined in House Bill 5321 to refer to an individual, firm, bank, financial institution, limited partnership, co-partnership, joint venture, association, corporation, receiver, estate, trust, or any other entity that invests in the Michigan Early Stage Venture Capital Investment Fund.

House Bill 5322 would amend the Income Tax Act (MCL 206.270) to provide that, for tax years beginning after 2009 and before 2020, a taxpayer to whom a certificate and remaining SBT credit amount had been transferred under House Bill 5320 could claim that credit against the income tax.

House Bill 5321 is tie-barred to the other two bills, which are each tie-barred to House Bill 5321. The following is a more detailed summary of the bills.

House Bill 5320

For tax years beginning after December 31, 2008, and before January 1, 2020, a taxpayer that was an “investor” (as defined earlier) could claim an SBT credit equal to the amount determined and certified under the proposed Michigan Early Stage Venture Capital Investment Act.

The credit allowed for any tax year could not exceed the difference between the amount actually repaid and the amount set as the repayment due in an agreement entered into by the taxpayer and the Michigan Early Stage Venture Capital Investment Corporation under the proposed act. If a taxpayer’s credit for a tax year exceeded the taxpayer’s tax liability for that tax year, the excess portion of the credit would be refunded.

For tax years beginning after December 31, 2009, if an SBT credit were not allowed against the taxpayer’s tax liability under the SBT Act or against any successor tax to the SBT, a taxpayer could transfer the certificate and the credit to a person who could claim the credit against the income tax, as provided in House Bill 5322.

House Bill 5321

Michigan Early Stage Venture Capital Investment Corporation. The Michigan Early Stage Venture Capital Investment Corporation would have to be incorporated as a nonprofit corporation with tax exempt status under the Internal Revenue Code by September 1, 2004. The

corporation would be a charitable and benevolent institution and its funds and property would be exempt from state and local taxes.

The bill would require that the corporation's articles of incorporation contain its purposes, including to "operate and act exclusively for charitable purposes with the intent to lessen the financial burdens of the government of [the] state"; to receive and administer funds for charitable purposes; to raise capital and invest it in venture capital firms to benefit Michigan's early stage, growth companies; to promote the state's economic health by assisting in creating new jobs, new businesses, and new industries and through investment in certain businesses; and to enter into an agreement with the state to promote Michigan's economic health.

The corporation would be subject to the Open Meetings Act. Information received, prepared, used, or retained by the corporation that was confidential financial or proprietary information would not be subject to the Freedom of Information Act.

Michigan Early Stage Venture Capital Investment Fund. The corporation would have to create a Michigan Early Stage Venture Capital Investment Fund, which would be a restricted fund. The fund manager would have to establish an investment plan for the money in the fund.

Not more than 15 percent of the fund's total capital and outstanding commitments could be invested in any single venture capital company. The fund manager would have to invest the fund with the aim that at least \$2 would be invested in qualified businesses for every \$1 of principal guaranteed by the state as tax credits available under HB 5320 and 5322.

Fund investments would have to facilitate the transfer of technologies from the state's universities and research institutions and meet other professional portfolio management criteria the fund manager and board considered appropriate. In addition, priorities for investment in venture capital could be based on an evaluation, which would have to consider the retention of businesses that would be likely to leave Michigan without the investment, the revitalization and diversification of the state's economic base, and the generation and retention of jobs and investment in the state.

The fund manager would have select venture capital companies considering the following criteria:

- The company's probability of success in generating above-average returns through investing in qualified businesses.
- The company's probability of success in soliciting investments.
- The company's probability of success regarding the target that \$2 be invested for every \$1 guaranteed by the state as tax credits.
- The company had a significant presence in Michigan, as determined by the corporation.
- The company's consideration of minority-owned businesses in its investment activities.

Investment from the fund committed to a venture capital company could not be more than 25 percent of the company's total capital under management.

Investor Agreements/Tax Credits. To secure investment in the fund, the corporation would have to enter into agreements with investors. Each agreement would have to contain all of the following:

- An established and agreed-upon investment amount and repayment schedule.
- A guaranteed negotiated amount or negotiated return on investment over the term of the agreement.
- A maximum amount of credit that the investor could claim under House Bill 5320 (the SBT or a successor) or House Bill 5322 (the income tax) and the first year in which a credit could be claimed.

The fund would have to repay any amounts due from proceeds of the money raised based on the investor agreements.

For tax years beginning after December 31, 2008, an investor that had a certificate could claim a tax credit under House Bill 5320 or House Bill 5322 that was equal to the difference between the amount actually repaid and the amount set in the agreement as the repayment due. The amount of the credit would become a guarantee of repayment and a debt of the fund to the Department of Treasury, subject to repayment under the agreement between the corporation and the department. The debt would accrue interest at the same rate as the interest paid to the investor. The guarantee would not be an obligation of the state and could be restricted to specific funds or assets of the corporation.

Tax Credit Certificates. The corporation would have to determine which investors were eligible for SBT credits under House Bill 5320 and income tax credits under House Bill 5322, and the amount of the tax credit allowed to each investor. The corporation would have to submit proposed tax credit certificates to the Department of Treasury. The department would have 30 days to approve or deny the proposed certificates within 30 days; if the department did not act within that time period, the certificates would be considered approved. If the department denied a proposed certificate, it would have to notify the corporation and the investor of the reason for the denial. The corporation would not be prohibited from submitting another proposed certificate on behalf of the same investor.

The corporation would have to issue to each investor a certificate, showing the amount of the credit, the tax years for which it could be claimed, and the maximum annual amount that could be claimed each tax year. A certificate would have to be issued at the time the corporation determined that, for that investor, capital was not sufficient to meet the guaranteed negotiated amount or the negotiated return on the investor's qualified investment. The total of all certificates issued could not exceed the maximum amount allowed under House Bill 5320.

The fund manager would have to invest, budget, and plan scheduled payments and repayments so that no credits were claimed under House Bill 5320 in any tax year before those beginning after December 31, 2008.

Application to Attorney General/Treasury for Registration. Before a nonprofit corporation applied for registration as the Michigan Early Stage Venture Capital Investment Corporation, it would have to submit its articles of incorporation to the attorney general for review and certification. If the submitted information complied with the bill's requirements, the attorney general would have to issue a certificate of compliance upon the payment of a \$100 fee. The state treasurer would have to examine the registration application and could conduct an investigation, request additional information, or examine under oath anyone interested in or connected with the nonprofit corporation. The state treasurer would have to register the nonprofit corporation if the application documents were in the proper form, the articles of incorporation met the bill's requirements, and the federal Internal Revenue Service had determined that the nonprofit corporation was exempt from taxation under the Internal Revenue Code.

Board of Directors. The Michigan Early Stage Venture Capital Investment Corporation would be governed by a board of directors consisting of seven members appointed by the governor, including the state treasurer or his or her designee, the chief executive officer of the Michigan Economic Development Corporation or his or her designee, two people recommended by the governor, one person recommended by the Senate Majority Leader, one person recommended by the Speaker of the House, and one person recommended by a statewide tax-exempt organization whose members represented more than 50 percent of the venture capital companies in Michigan. The recommended board members would serve three-year terms, although initial terms would be staggered. The bill would make the governor's appointments subject to advise and consent by the Senate and House of Representatives.

Conflict of Interest. The bill would prohibit a director, employee, or agent of the board from engaging in any conduct that would constitute a conflict of interest. A director, employee, or agent immediately would have to advise the board of the any incident or circumstance that could present a conflict of interest. A director who had a conflict of interest on any matter would have to refrain from voting on it, participating in discussions and deliberations on the matter or being present at a meeting at which discussion, deliberation, and voting on the matter occurred. Failure of a director to comply with those requirements would constitute misconduct in office and the director could be removed from the board by a majority vote of the remaining directors.

Fiduciary Duties. Each director would have to exercise the duties of a fiduciary and discharge his or her duties with the degree of diligence, care, and skill that an ordinarily prudent person would exercise under the same or similar circumstances in a like position. A director could be removed from the board for a breach of fiduciary duty by a vote of the remaining directors.

Liability/Indemnification. A director or an officer or employee of the board or the corporation would not be subject to personal liability when acting in good faith within the scope of his or her authority or on account of liability of the corporation, and the board could defend and indemnify a director, officer, or employee against liability arising out of the discharge of his

or her official duties. Also, the corporation could indemnify and procure insurance indemnifying directors, officers, and employees from personal loss or accountability for liability regarding actions of the board or the failure of the board or corporation to act.

Corporation Duties and Responsibilities. The Michigan Early Stage Venture Capital Investment Corporation could perform or delegate any act consistent with the proposed act and the purposes of the nonprofit corporation, including:

- Entering into contacts and all necessary activities of the corporation.
- Charging reasonable fees for the implementation of the act and the ongoing operation of the corporation.
- Performing acts or entering into transactions necessary to carry out the corporation's powers and duties.
- Employing a fund manager and others the corporation considered necessary to implement the act.

Annual Report. The corporation would have to publish an annual report within three months after the close of its fiscal year. The report would have to include an enumeration of all investments and related activities for that fiscal year and documentation and analysis of the implementation and status of the corporation's investment plan and the plan's economic impact on the state. The documentation and analysis would have to include both the number of jobs represented by the investments made in qualified businesses in Michigan; and the return on investment generated by investment, the types of activities in which investment was made, and the impact of that investment on Michigan's economic base.

Findings and Purposes. The bill contains a section of findings, in which it states that the legislature finds the following:

- "There exists a need to promote the economic health of this state by assisting in the creation of new jobs, new businesses, and new industries . . . and through the investment in certain businesses that focus on areas including, but not limited to, alternative energy technology, high-technology, and health care.
- Investing in businesses that are early stage growth companies and promoting economic growth in the state assist the state in carrying out its essential governmental functions and as such are essential public purposes.
- Investments in certain businesses promote the retention of businesses and jobs that would be likely to leave the state absent the investment, revitalize and diversify the economic base of this state, generate and retain jobs and investment in this state, and help to effectuate legislative and governmental programs to promote economic growth.
- Agreements with private corporations such as Michigan early stage venture investment corporations can assist the state by raising capital and investing that capital in venture capital firms with the intent to benefit this state's early stage growth companies thus facilitating

economic growth and development and other government programs and supporting essential public purposes.”

The bill declares that the purposes of the act are 1) to promote a healthy economic climate in this state by fostering job creation, retention, and expansion, through the promotion of investment in certain businesses; and 2) to allow the state to enter into agreements with Michigan early stage venture investment corporations to promote a healthy economic climate.

Enacting Section. The bill contains an enacting section as follows: “The State of Michigan has engaged in activities on a regular basis and for a significant amount of time intended to promote the overall economic development of the state. The cost of funding these activities is recognized as a burden on this state that can be lessened through the establishment and registration of Michigan early stage venture investment corporations and . . . funds. By working cooperatively with this state, Michigan early stage venture investment corporations will benefit the general public, thus assisting this state in carrying out its essential functions, including the promotion of economic development in this state. If this legislation does not become law, the opportunity to help carry that burden will be lost to the state and a greater burden will remain on the government and the general public for future activities to promote economic development in the state.”

House Bill 5322

For tax years beginning after December 31, 2009, and before January 1, 2020, a taxpayer to whom a certificate and remaining credit amount were transferred under House Bill 5320 could claim that credit against the income tax in an amount equal to the transferred credit.

An income tax credit could be claimed only in a tax year in which the credit against the SBT under House Bill 5320, or against a successor tax to the SBT, was not allowed. The income tax credit allowed for any tax year could not exceed the amount transferred and allowed on the certificate. If the taxpayer’s credit for a tax year exceeded his or her tax liability for that year, the excess portion of the credit would have to be refunded.

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that the fiscal impact of the bills is indeterminate. The HFA notes that it is not possible to predict with any accuracy the number of corporations that would be created, the dollar amount of investment, or the economic impact. Under the bill, no more than \$30 million in credits can be awarded in any one year, and no more than \$150 million in credits can be awarded during the life of the act. The act requires that the fund reimburse the state for any credits against the SBT or income tax; however, the timing of the payments may be such that the state is not reimbursed until much later. (HFA analysis dated 12-3-03)

POSITIONS:

The Department of Treasury expressed support for the concept of the bill to the House Committee on Commerce, although the department has concerns about some specific provisions and described the bill as “a work in progress”. (12-3-03)

Among those testifying in support of the bills were the Michigan Venture Capital Association; the Small Business Association of Michigan; and a representative from the Automation Alley Tech Center in Troy. (12-03-03)

Analyst: M. Wolf/C. Couch

■ 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.