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BILL



ANALYSIS

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Senate Bills 834, 835, and 836 (as introduced 11-6-03)  
Sponsor: Senator Michael D. Bishop (Senate Bill 834)  
Senator Tom George (Senate Bill 835)  
Senator Nancy Cassis (Senate Bill 836)  
Committee: Commerce and Labor

Date Completed: 11-12-03

## **CONTENT**

**Senate Bill 834** would create the "Michigan Early Stage Venture Capital Investment Act" to require that, within one year after the bill's effective date, the "Michigan Early Stage Venture Capital Investment Corporation" be established, a fund manager be hired, an investment plan be established, and funds be solicited and available for investment consistent with that 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.

**Senate Bill 835** would amend the Single Business Tax Act to specify that, for tax years beginning after 2008 and before 2020, a taxpayer that was an investor could claim an SBT credit equal to the amount determined and certified under Senate Bill 834. 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 Senate Bill 836). 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.

**Senate Bill 836** would amend the Income Tax Act 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 Senate Bill 835 could claim that credit against the income tax.

Senate Bill 834 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 as a site located in Michigan. "Seed or early stage business" would mean a business that had less than \$15 million in gross receipts and fewer than 200 employees for the calendar year immediately preceding initial investment in the business by a venture capital company. Senate Bill 834 is tie-barred to Senate Bills 835 and 836, which are tie-barred to Senate Bill 834.

## **Senate Bill 834**

### **Michigan Early Stage Venture Capital Investment Corporation**

The Michigan Early Stage Venture Capital Investment Corporation would have to be incorporated as a nonprofit corporation or be a governmental agency under the Internal Revenue Code by July 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 for charitable purposes with the intent to lessen the state's financial burdens"; 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 Michigan's economic health by assisting in creating new jobs, businesses, and 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.

Up to 15% 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 to "promote" that at least \$2 would be invested in qualified businesses for every \$1 of principal guaranteed by the State as tax credits available under Senate Bills 835 and 836.

Fund investments would have to facilitate the transfer of technologies from the State's universities and research institutions and promote the ability to work in collaboration with the Regional Transit Coordinating Council established under the Metropolitan Transportation Authorities Act. 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 Michigan's economic base, and the generation and retention of jobs and investment in Michigan.

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 criterion 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 would undertake to invest in qualified businesses a percentage of invested capital equal to or greater than the percentage of invested capital that the company received from the Fund.
- 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% 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 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 Senate Bill 835 or 836 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 Senate Bill 835 or 836 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 pursuant to 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 Senate Bill 835 and income tax credits under Senate Bill 836, 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. If the Department did not approve the proposed certificates within 30 days, they would be considered approved.

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 Senate Bill 835.

The fund manager would have to invest, budget, and plan scheduled payments and

repayments so that no credits were claimed under Senate Bill 835 in any tax year before those beginning after December 31, 2008.

#### Application 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 IRS had determined that the nonprofit corporation was exempt from taxation or was a governmental agency under the Internal Revenue Code.

#### Board of Directors

Membership. The Michigan Early Stage Venture Capital Investment Corporation would be governed by a board of directors consisting of five 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, 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% of the venture capital companies in Michigan. The recommended board members would serve three-year staggered terms.

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 & 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 of the following:

- The number of jobs represented by the investments made in qualified businesses in Michigan.
- 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.

#### **Senate Bill 835**

For tax years beginning after December 31, 2008, and before January 1, 2020, a taxpayer that was an investor 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 have to 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 Senate Bill 836.

#### **Senate Bill 836**

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 Senate Bill 835 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 Senate Bill 835, 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.

Proposed MCL 208.37e (S.B. 835)

Proposed MCL 206.270 (S.B. 836)

Legislative Analyst: Patrick Affholter

### **FISCAL IMPACT**

It is not possible to provide a meaningful estimate of the fiscal impact of these bills because there are too many unknown factors. For example, there is no way to know, 1) how much investors would be willing to invest in this type of investment fund, 2) the rate of return that would be guaranteed to individual investors, 3) the ultimate actual rate of return that would be realized by this fund, or 4) the amount that investors would be eligible to claim as refundable credits against the single business tax or income tax, if the actual rate of return turned out to be less than the guaranteed rate of return. The only thing known for sure is that under these bills, the total credits paid to investors could not exceed \$30 million in any one year and \$150 million during the life of the fund, and investors could not claim these credits until 2009. While the bills would require the fund to repay the State for all the tax credits claimed by investors, the timing of these repayments is unclear. As a result, the maximum initial cost to the State would be \$30 million in any given year and \$150 million over the life of the fund, and the earliest this initial cost could be incurred would be FY 2009-10; however, over the longer term, the maximum potential cost to the State would probably be much less, or even zero, assuming the fund would eventually repay the State, with interest, for some or all of the credits paid to investors.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.