

SENATE BILL 1203

By Overbey

AN ACT to amend Tennessee Code Annotated, Title 4 and Title 56, to enact the "Tennessee Small Business Investment Company Credit Act".

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 4, is amended by adding Sections 2 through 13 of this act as a new chapter.

SECTION 2. This chapter shall be known and may be cited as the "Tennessee Small Business Investment Company Credit Act".

SECTION 3. As used in this chapter:

(1) "Affiliate" means:

(A)

(i) Any person who, directly or indirectly, beneficially owns, controls, or holds power to vote fifteen percent (15%) or more of the outstanding voting securities or other voting ownership interest of a Tennessee small business investment company or insurance company;

(ii) Any person, fifteen percent (15%) or more of whose outstanding voting securities or other voting ownership interests are directly or indirectly beneficially owned, controlled, or held with power to vote by a Tennessee small business investment company or insurance company.

(B) Notwithstanding subdivision (1)(A), an investment by a participating investor in a Tennessee small business investment company pursuant to an allocation of premium tax credits under this chapter does not cause that

Tennessee small business investment company to become an affiliate of that participating investor;

(2) "Allocation date" means the date on which credits under Section 6 are allocated to the participating investors of a Tennessee small business investment company under this chapter;

(3) "Department" means the department of economic and community development;

(4) "Designated capital" means an amount of money that:

(A) Is invested by a participating investor in a Tennessee small business investment company; and

(B) Fully funds the purchase price of either or both participating investor's equity interest in a Tennessee small business investment company or a qualified debt instrument issued by a Tennessee small business investment company;

(5) "Participating investor" means any insurance company required to pay the tax on gross premiums pursuant to § 56-4-205;

(6) "Person" means any natural person or entity, including, but not limited to, a corporation, general or limited partnership, trust, or limited liability company;

(7)

(A) "Qualified business" means a business that is independently owned and operated and meets all of the following requirements:

(i) Is headquartered in Tennessee, its principal business operations are located in this state, and at least sixty percent (60%) of its employees are located in Tennessee;

(ii) Has not more than one hundred (100) employees;

(iii) Is not predominantly engaged in:

(a) Professional services provided by accountants, doctors, or lawyers;

(b) Banking or lending;

(c) Real estate development;

(d) Insurance;

(e) Oil and gas exploration;

(f) Direct gambling activities; or

(g) Making loans to or investments in a Tennessee small business investment company or an affiliate; and

(iv) Is not a franchise of and has no financial relationship with a Tennessee small business investment company or any affiliate of a Tennessee small business investment company prior to a Tennessee small business investment company's first qualified investment in the business;

(B) A business classified as a qualified business at the time of the first qualified investment in the business shall remain classified as a qualified business and may receive continuing qualified investments from any Tennessee small business investment company. Continuing investments shall constitute qualified investments even though the business may not meet the definition of a qualified business at the time of such continuing investments.

(8) "Qualified debt instrument" means a debt instrument issued by a Tennessee small business investment company which meets all of the following criteria:

(A) Is issued at par value or a premium; and

(B) Has an original maturity date of at least four (4) years from the date of issuance, and a repayment schedule which is not faster than a level principal amortization over four (4) years;

(9) "Qualified distribution" means any distribution or payment not made to a participating investor or affiliate of a participating investor by a Tennessee small business investment company in connection with the following:

(A) Costs and expenses of forming, syndicating, and organizing the Tennessee small business investment company, including fees paid for professional services, and the costs of financing and insuring the obligations of a Tennessee small business investment company;

(B) An annual management fee not to exceed two percent (2%) of designated capital on an annual basis to offset the costs and expenses of managing and operating a Tennessee small business investment company;

(C) Reasonable and necessary fees in accordance with industry custom for ongoing professional services, including, but not limited to, legal and accounting services related to the operation of a Tennessee small business investment company, not including any lobbying or governmental relations;

(D) Any increase or projected increase in federal or state taxes, including penalties and related interest of the equity owners of a Tennessee small business investment company resulting from the earnings or other tax liability of a Tennessee small business investment company to the extent that the increase is related to the ownership, management, or operation of a Tennessee small business investment company; and

(E) Payments of principal and interest to holders of qualified debt instruments issued by a Tennessee small business investment company may be made without restriction whatsoever;

(10) "Qualified investment" means the investment of money by a Tennessee small business investment company in a qualified business for the purchase of any debt, debt participation, equity, or hybrid security of any nature and description whatsoever, including a debt instrument or security that has the characteristics of debt but which provides for conversion into equity or equity participation instruments such as options or warrants. Any repayment of a qualified investment prior to one (1) year from the date of issuance shall result in the amount of such qualified investment being reduced by fifty percent (50%) for purposes of the cumulative investment requirement set forth in Section 10(c);

(11) "State premium tax liability" means any liability incurred by an insurance company under the provisions of § 56-4-205 or in the case of a repeal or a reduction by the state of the liability imposed by § 56-4-218, any other tax liability imposed upon an insurance company by the state; and

(12) "Tennessee business investment company" means a partnership, corporation, trust, or limited liability company, organized on a for-profit basis, that:

(A) Has its principal office located or is headquartered in Tennessee;

(B) Has as its primary business activity the investment of cash in qualified businesses; and

(C) Is certified by the department as meeting the criteria in this chapter.

#### SECTION 4.

(a) The department shall provide a standardized format for applying for the business investment credit.

(b) An applicant is required to:

(1) File an application with the department;

(2) Pay a nonrefundable application fee of seven thousand five hundred dollars (\$7,500) at the time of filing the application;

(3) Submit as part of its application an audited balance sheet that contains an unqualified opinion of an independent certified public accountant issued not more than thirty five (35) days before the application date that states that the applicant has an equity capitalization of five hundred thousand dollars (\$500,000) or more in the form of unencumbered cash, marketable securities, or other liquid assets; and

(4) Have at least two (2) principals or persons, at least one (1) of whom is primarily located in Tennessee, employed or engaged to manage the funds who each have a minimum of five (5) years of money management experience in the venture capital or small business investment industry.

(c) The department may certify partnerships, corporations, trusts, or limited liability companies, organized on a for-profit basis, which submit an application to be designated as a Tennessee small business investment company if such applicant is located, headquartered, and licensed or registered to conduct business in Tennessee, has as its primary business activity the investment of cash in qualified businesses, and meets the other criteria set forth in this chapter.

(d) The department shall review the organizational documents of each applicant for certification and the business history of each applicant, determine whether the applicant has satisfied the requirements of this chapter, and determine whether the

officers and the board of directors, general partners, trustees, managers, or members are trustworthy and are thoroughly acquainted with the requirements of this chapter.

(e) Within forty five (45) days after the receipt of an application, the department must issue the certification or refuse the certification and communicate in detail to the applicant the grounds for refusal, including suggestions for the removal of such grounds.

(f) The department shall begin accepting applications to become a Tennessee small business investment company by August 1, 2009.

#### SECTION 5.

(a) An insurance company or affiliate of an insurance company shall not, directly or indirectly:

(1) Beneficially own, whether through rights, options, convertible interest, or otherwise, fifteen percent (15%) or more of the voting securities or other voting ownership interest of a Tennessee small business investment company;

(2) Manage a Tennessee business investment company; or

(3) Control the direction of investments for a Tennessee business investment company.

(b) A Tennessee small business investment company may obtain one (1) or more guaranties, indemnities, bonds, insurance policies, or other payment undertakings for the benefit of its participating investors from any entity, except that in no case shall more than one (1) participating investor of a Tennessee small business investment company on an aggregate basis with all affiliates of such participating investor be entitled to provide such guaranties, indemnities, bonds, insurance policies, or other payment undertakings in favor of the participating investors of a Tennessee small business investment company and its affiliates in this state.

(c) This section does not preclude a participating investor, insurance company, or other party from exercising its legal rights and remedies, including, without limitation, interim management of a Tennessee business investment company, in the event that a Tennessee small business investment company is in default of its statutory obligations or its contractual obligations to such participating investor, insurance company, or other party, or from monitoring a Tennessee small business investment company to ensure its compliance with this chapter nor disallowing any investments that have not been approved by the department.

(d) The department may contract with an independent third party to review, investigate, and certify that the applications comply with the provisions of this chapter.

#### SECTION 6.

(a) The aggregate amount of investment tax credits to be allocated to all participating investors of Tennessee business investment companies under this chapter shall not exceed one hundred million dollars (\$100,000,000). No Tennessee small business investment company, on an aggregate basis with its affiliates, may file credit allocation claims that exceed one hundred million dollars (\$100,000,000).

(b) Credits must be allocated to participating investors in the order that the credit allocation claims are filed with the department, provided that all credit allocation claims filed with the department on the same day must be treated as having been filed contemporaneously. Any credit allocation claims filed with the department prior to the initial credit allocation claim filing date shall be deemed to have been filed on such initial credit allocation claim filing date. The department shall set the initial credit allocation claim filing date to be not less than one hundred twenty (120) days and not greater than one hundred fifty (150) days after the department begins accepting applications for certification.



(c) In the event that two (2) or more Tennessee small business investment companies file credit allocation claims with the department on behalf of their respective participating investors on the same day, and the aggregate amount of credit allocation claims exceeds the aggregate limit of investment tax credits under this chapter or the lesser amount of credits that remain unallocated on that day, then the credits shall be allocated among the participating investors who filed on that day on a pro rata basis with respect to the amounts claimed. The pro rata allocation for any one (1) participating investor is the product obtained by multiplying a fraction, the numerator of which is the amount of the credit allocation claim filed on behalf of a participating investor and the denominator of which is the total of all credit allocation claims filed on behalf of all participating investors on that day, by the aggregate limit of credits under this chapter or the lesser amount of credits that remain unallocated on that day.

(d) Within ten (10) business days after the department receives a credit allocation claim filed by a Tennessee small business investment company on behalf of one (1) or more of its participating investors, the department must notify the Tennessee small business investment company of the amount of credits allocated to each of the participating investors of that Tennessee business investment company. In the event a Tennessee small business investment company does not receive an investment of designated capital from each participating investor required to earn the amount of credits allocated to such participating investor within ten (10) business days of the Tennessee business investment company's receipt of notice of allocation, then the company shall notify the department on or before the next business day, and the credits allocated to such participating investor of the Tennessee small business investment company shall be forfeited. The department must then reallocate those forfeited credits among the participating investors of the other Tennessee business investment companies on a pro

rata basis with respect to the credit allocation claims filed on behalf of the participating investors. The commissioner is authorized, but not required, to levy a fine of not more than fifty thousand dollars (\$50,000) on any participating investor that does not invest the full amount of designated capital required to fund the credits allocated to it by the department in accordance with the credit allocation claim filed on its behalf.

(e) No participating investor, on an aggregate basis with its affiliates, may file an allocation claim for more than twenty-five percent (25%) of the maximum amount of investment tax credits authorized under this chapter, regardless of whether such claim is made in connection with one (1) or more Tennessee small business investment companies.

#### SECTION 7.

(a) To maintain its certification, a Tennessee small business investment company must make qualified investments as follows:

(1) Within two (2) years after the allocation date, a Tennessee small business investment company must invest an amount equal to at least thirty-five percent (35%) of its designated capital in qualified investments; and

(2) Within three (3) years after the allocation date, a Tennessee small business investment company must invest an amount equal to at least fifty percent (50%) of its designated capital in qualified investments.

(b) Prior to making a proposed qualified investment in a specific business, a Tennessee small business investment company must request from the department a written determination that the proposed investment will qualify as a qualified investment in a qualified business. The department must notify a Tennessee small business investment company within ten (10) business days from the receipt of a request of its determination and an explanation thereof. If the department fails to notify the

Tennessee small business investment company of its determination within the ten-business-day period, the proposed investment must be deemed to be a qualified investment in a qualified business. If the department determines that the proposed investment does not meet the definition of a qualified investment or qualified business or both, the department may nevertheless consider the proposed investment a qualified investment, and if necessary, the business a qualified business, if the department determines that the proposed investment will further state economic development.

(c) All designated capital not invested in qualified investments by a Tennessee small business investment company shall be held or invested in such manner as the Tennessee business investment company, in its discretion, deems appropriate. Designated capital and proceeds of designated capital returned to a Tennessee small business investment company after being originally invested in qualified investments may be invested again in qualified investments and such investment shall count toward the requirements of subsection (a) with respect to making investments of designated capital in qualified investments.

(d) If, within four (4) years after its allocation date, a Tennessee small business investment company has not invested at least sixty percent (60%) of its designated capital in qualified investments, neither the Tennessee small business investment company nor its affiliates shall be permitted to receive management fees.

(e) If, within six (6) years after its allocation date, a Tennessee small business investment company has not invested at least one hundred percent (100%) of its designated capital in qualified investments, neither the Tennessee small business investment company nor its affiliates shall be permitted to receive management fees.

(f) A Tennessee small business investment company may not invest more than fifteen percent (15%) of its designated capital in any one (1) qualified business without the specific approval of the department.

(g) For purposes of calculating the above investment percentage thresholds of subsection (a), the cumulative amount of all qualified investments made by a Tennessee small business investment company from the allocation date must be considered.

#### SECTION 8.

(a) Each Tennessee small business investment company must report the following to the department:

(1) As soon as practicable after the receipt of designated capital:

(A) The name of each participating investor from which the designated capital was received, including such participating investor's insurance tax identification number;

(B) The amount of each participating investor's investment of designated capital; and

(C) The date on which the designated capital was received;

(2) On an annual basis, on or before January 31 of each year:

(A) The amount of the Tennessee business investment company's remaining uninvested designated capital at the end of the immediately preceding taxable year;

(B) Whether or not the Tennessee small business investment company has invested more than fifteen percent (15%) of its total designated capital in any one (1) business;

(C) All qualified investments that the Tennessee small business investment company has made in the previous taxable year, including the

number of employees of each qualified business in which it has made investments at the time of such investment and as of December 1 of the preceding taxable year; and

(D) For any qualified business where the Tennessee small business investment company no longer has an investment, the Tennessee small business investment company must provide employment figures for that company as of the last day before the investment was terminated;

(3) Other information that the department may reasonably request that will help the department ascertain the impact of the Tennessee small business investment company program both directly and indirectly on the economy of the state of Tennessee, including, but not limited to, the number of jobs created by qualified businesses that have received qualified investments;

(4) Within ninety (90) days of the close of its fiscal year, annual audited financial statements of the Tennessee business investment company, which must include the opinion of an independent certified public accountant; and

(5) An “agreed upon procedures report” or equivalent regarding the operations of the Tennessee small business investment company.

(b) A Tennessee small business investment company must pay to the department an annual, nonrefundable certification fee of five thousand dollars (\$5,000) on or before April 1, or ten thousand dollars (\$10,000) if later than April 1. No annual certification fee is required if the payment date for such fee is within six (6) months of the date a Tennessee small business investment company is first certified by the department.

(c) Upon satisfying the requirements of Section 7(a)(2), a Tennessee small business investment company shall provide notice to the department and the department shall, within sixty (60) days of receipt of such notice, either confirm that the Tennessee small business investment company has satisfied the requirements of Section 7(a)(2) as of such date or provide notice of non-compliance and an explanation of any existing deficiencies. If the department does not provide such notification within sixty (60) days, the Tennessee small business investment company shall be deemed to have met the requirements of Section 7(a)(2).

SECTION 9. A Tennessee small business investment company may make qualified distributions at any time. In order for a Tennessee small business investment company to make a distribution other than a qualified distribution to its equity holders, the cumulative amount of all qualified investments of the Tennessee small business investment company must equal or exceed one hundred percent (100%) of its designated capital.

SECTION 10.

(a) The department shall conduct an annual review of each Tennessee small business investment company to determine if a Tennessee small business investment company is abiding by the requirements of certification and to ensure that no investment has been made in violation of this chapter. The cost of the annual review must be paid by each Tennessee small business investment company according to a reasonable fee schedule adopted by the department.

(b) Any material violation of this chapter, including any material misrepresentation made to the department in connection with the application process, may be grounds for decertification of a Tennessee small business investment company and the disallowance of credits under Section 13, provided that in all instances the department shall provide notice to the Tennessee business investment of the grounds of

such proposed decertification and the opportunity to cure such violation before any such decertification shall become effective

(c) Once a Tennessee small business investment company has invested an amount cumulatively equal to one hundred percent (100%) of its designated capital in qualified investments, provided that the Tennessee small business investment company has met all other requirements under this chapter as of such date, the Tennessee small business investment company shall no longer be subject to regulation by the department or the reporting requirements under Section 8. Upon receiving certification by a Tennessee small business investment company that it has invested an amount equal to one hundred percent (100%) of its designated capital, the department shall notify a Tennessee small business investment company within sixty (60) days that it has or has not met the requirements, with a reason for the determination if it has not. If the department does not provide notification of deregulation within sixty (60) days, the Tennessee small business investment company shall be deemed to have met the requirements and shall be deemed to no longer be subject to regulation by the department.

(d) The department shall send written notice of any decertification proceedings to the commissioner of revenue and to the address of each participating investor whose tax credit may be subject to recapture or forfeiture, using the address shown on the last filing submitted to the department.

SECTION 11. All investments by participating investors for which tax credits are awarded under this chapter must be registered or specifically exempt from registration.

SECTION 12. The department shall make an annual report to the governor and the finance, ways and means committees of the senate and house of representatives, the

commerce committee of the house of representatives and the senate commerce, labor and agriculture committee. The report shall include:

- (1) The number of Tennessee business investment companies holding designated capital;
- (2) The amount of designated capital invested in each Tennessee business investment company;
- (3) The cumulative amount that each Tennessee small business investment company has invested as of January 1, 2010, and the cumulative total by January 1 each year thereafter;
- (4) The cumulative amount of follow-on capital that the investments of each Tennessee small business investment company have created in terms of capital invested in qualified businesses at the same time or subsequent to investments made by a Tennessee small business investment company in such businesses by sources other than Tennessee business investment companies;
- (5) The total amount of investment tax credits applied under this chapter for each year;
- (6) The performance of each Tennessee small business investment company with regard to the requirements for continued certification;
- (7) The classification of the companies in which each Tennessee small business investment company has invested according to industrial sector and size of company;
- (8) The gross number of jobs created by investments made by each Tennessee small business investment company and the number of jobs retained;
- (9) The location of the companies in which each Tennessee small business investment company has invested;



(10) Those Tennessee business investment companies that have been decertified, including the reasons for decertification; and

(11) Other related information as necessary to evaluate the effect of this chapter on economic development.

### SECTION 13.

(a) A participating investor shall earn a credit against the tax imposed pursuant to § 56-4-205 equal to eighty percent (80%) of the participating investor's investment of designated capital in a Tennessee small business investment company. Beginning January 1, 2013, a participating investor may claim the credit as follows:

(1) In tax year 2013, an amount equal to twenty percent (20%) of the participating investor's investment of designated capital;

(2) In tax year 2014, an amount equal to twenty percent (20%) of the participating investor's investment of designated capital;

(3) In tax year 2015, an amount equal to twenty percent (20%) of the participating investor's investment of designated capital; and

(4) In tax year 2016, an amount equal to twenty percent (20%) of the participating investor's investment of designated capital.

(b) The credit for any taxable year must not exceed the liability for the tax imposed pursuant to § 56-4-205 for such year. If the amount of the credit determined under this section for any taxable year exceeds the liability for such tax, the excess shall be an investment tax credit carryover to future taxable years without limitation. Credits may be used in connection with both final payments and prepayments of a participating investor's state premium tax liability.

(c) A participating investor claiming a credit under this section is not required to pay any additional retaliatory tax levied as a result of claiming the credit.

(d) A participating investor is not required to reduce the amount of tax pursuant to the state premium tax liability included by the participating investor in connection with ratemaking for any insurance contract written in this state because of a reduction in the participating investor's tax liability based on the tax credit allowed under this section.

(e) If the taxes paid by a participating investor with respect to its state premium tax liability constitute a credit against any other tax that is imposed by this state, the participating investor's credit against the other tax shall not be reduced by virtue of the reduction in the participating investor's tax liability based on the tax credit allowed under this section.

(f) Final decertification of a Tennessee small business investment company under Section 10 may result in the disallowance and the recapture of the credit allowed under this section. The amount to be disallowed and recaptured must be assessed as follows:

(1) Decertification of a Tennessee small business investment company within two (2) years of its allocation date and prior to meeting the requirements of Section 7(a)(1) shall result in the disallowance of all of the credits allowed under this section; and

(2) Decertification of a Tennessee small business investment company that has already met the requirements of Section 7(a)(1) shall not cause the disallowance of any credits allowed under this section nor the recapture of any portion of the credits that was previously taken.

(g) A participating investor must not transfer, agree to transfer, sell, or agree to sell the credit under this section until one hundred eighty (180) days from the date on which the participating investor invested designated capital. After one hundred eighty (180) days from the date of investment, a participating investor, or subsequent

transferee, may transfer credits based upon rules adopted by the department to facilitate such transfers. Any transfer or sale of the credits does not affect the time schedule for claiming the credit. Any tax credits recaptured under this section remain the liability of the participating investor that actually applied the credit towards its tax liability.

SECTION 14. This act shall take effect upon becoming a law, the public welfare requiring it.