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**HOUSE OF REPRESENTATIVES
COMMITTEE ON
INFORMATION TECHNOLOGY
ANALYSIS**

BILL #: HB 243
RELATING TO: Certified Capital Company Act
SPONSOR(S): Representative Mack
TIED BILL(S):

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

- (1) INFORMATION TECHNOLOGY
 - (2) FISCAL POLICY AND RESOURCES
 - (3) COUNCIL FOR READY INFRASTRUCTURE
 - (4)
 - (5)
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I. SUMMARY:

This bill would amend the Certified Capital Company Act, s. 288.99, F.S. (the "Act"), by creating a second program to succeed the first program (now expired) and provide an additional \$300 million in insurance premium tax credits to stimulate the growth of technology and small businesses in Florida.

The bill would:

- Revise the definitions of "affiliate of an insurance company," "certified capital company," "early stage technology business," "qualified business," "qualified distribution," and "qualified investment;
- Create definitions of "Program One" and "Program Two;"
- Require an applicant under "Program Two" to file its application with the Department of Banking and Finance on or before November 1, 2002;
- Require an applicant under "Program Two" to, within 90 days before filing its application, provide the Department with a verified audit report on its financial condition and history showing that it has a net worth of at least \$500,000;
- Require an applicant under "Program Two" to provide the Department with a copy of any offering materials used in soliciting investments of certified capital; Requires the Department to determine whether an applicant's proposed method of doing business and raising certified capital conforms with the requirements of the Act;
- Establish December 31, 2002 as the deadline for the Department to grant or deny certification as a CAPCO to an applicant under "Program Two;"
- Eliminate the requirement that a CAPCO file a copy of its certification with OTTED;
- Prohibit an insurance company or its affiliates from owning or controlling 15 percent or more of the equity interests in a CAPCO;
- Impose a \$5,000 late fee for any CAPCO that fails to pay the annual renewal certification fee by December 31 each year;
- Require all CAPCOs to file audited financial statements with the Department by April 30 each year;
- Schedule progressive investment of certified capital for CAPCOs under "Program Two;"
- Authorize a qualified exception for investment of certified capital not invested in qualified investments to allow investment of such capital to be made in certain obligations issued by insurance companies;
- Restrict certified investors to using no more than 10% of vested premium tax credit under each program ("Program One" and "Program Two");
- Limit the total tax credits available under "Program Two" to \$300 million;

- Limit the total amount of tax credits that can be used annually by certified investors under “Program Two” to \$5 million;
- Establish a March 15, 2003, deadline for CAPCOs under “Program Two” to apply for an allocation of premium tax credits;
- Prohibit any CAPCO from claiming premium tax credits for certified investors that total an amount in excess of the amount appropriated by the Legislature;
- Prohibit any allocation to a CAPCO under “Program Two,” unless the CAPCO has filed premium tax allocation claims that total at least \$15 million;
- Establish April 1, 2003, as the deadline for OTTED to inform each CAPCO under “Program Two” of its share of total premium tax credits available for allocation to each of its potential investors;
- Authorize the Department to levy a fine up to \$50,000 on any certified investor that fails to invest the full amount of certified capital allocated to the investor;
- Establish a formula for determining the premium tax credits to be allocated to a certified investor when the total of capital committed by all certified investors to CAPCOs under “Program Two” exceeds the total of credits that may be awarded under “Program Two;”
- Limit to \$7.5 million the amount of certified capital for which premium tax allocation claims may be filed by one or more CAPCOs for any certified investor; Require OTTED to issue a certification letter validated by the CAPCO for each certified investor in the CAPCO showing the amount invested in the CAPCO under “Program One” and under “Program Two;”
- Establish January 31 of each year as the deadline for CAPCOs to file with the Department and OTTED a report stating the total amount the CAPCO received from certified investors in the preceding year, the total amount the CAPCO invested in the preceding year, and the total number of full-time jobs created or retained in the preceding year; and
- Restrict distributions made by CAPCOs to funds related to a particular program.

The bill proposes that the amendments to the Act would take effect on July 1, 2001.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

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|-----------------------------------|---|--|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input checked="" type="checkbox"/> | N/A <input type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a “no” above, please explain: By adding “Program Two” the Act would be extended for the duration of “Program Two.” The duties and responsibilities the Act presently imposes on the Department of Banking and Finance, the Department of Revenue, and OTTED for administration of “Program One” would be extended to administration of “Program Two.”

B. PRESENT SITUATION

Overview of the CAPCO Program

The Certified Capital Company Act, s. 288.99, F.S. was adopted in 1998 to establish a mechanism to provide venture capital financing, via certified capital companies (CAPCOs), to qualified small businesses. The Act was intended to increase the number of Florida-based certified venture capitalists, to facilitate access to institutional investors for smaller companies, and to create high-paying, high-skilled jobs.

The Act authorized corporations, partnerships, or limited liability companies to apply for certification as a CAPCO on or before December 1, 1998. CAPCOs, in short, are venture capital firms that receive capital from insurance companies (certified investors) to make early-stage investment capital investments in other businesses. As certified investors, insurance companies can, within limits, receive a credit against state premium taxes for each dollar invested in a CAPCO at the rate of 10 percent a year for 10 years, beginning with premium tax filings for the year 2000. The purpose of these tax credits was to encourage insurance companies to invest in certified capital companies, which, in turn, would make investments in qualified small businesses. The total of tax credits could not exceed \$15 million annually; the tax credits were subject to an aggregate cap of \$150 million.

Three entities are responsible for administration of the CAPCO program. The Department of Banking and Finance is responsible for certification and de-certification. The Department of Revenue oversees the tax credit filings and related requirements. The Office of Tourism, Trade, and Economic Development (OTTED) is responsible for the initial allocation of premium tax credits and for preparing an annual report on the CAPCO program.

Certification Requirements

To have been certified, a CAPCO must have had net capital of at least \$500,000. At least two of its principals must have demonstrated 5 years of experience in making venture capital investments. The CAPCO must have submitted an application to the Department of Banking and Finance, along with a \$7,500 application fee. Each CAPCO was and is required to pay an annual renewal fee of \$5,000 to the Department of Banking and Finance.

To remain certified, CAPCOs are required to meet statutorily defined investment benchmarks. "Qualified business" means a small business (determined by rules of the U.S. Small Business Administration) headquartered in Florida and with its principal business operations in Florida. By December 31, 2000, at least 20 percent of CAPCO funds must have been invested in qualified businesses. At least 30 percent of CAPCO funds must have been invested in qualified businesses by December 31, 2001. By December 31, 2002, at least 40 percent of CAPCO funds must be invested in qualified businesses. By December 31, 2003, at least 50 percent of CAPCO funds must be invested in qualified businesses.

A qualified business must certify that it is unable to obtain conventional financing and that it has fewer than 200 employees, at least 75 percent of whom are employed in Florida.

A qualified business does not include a business predominantly engaged in retail sales, real estate development, insurance, banking, lending, oil and gas exploration, or engaged in professional services provided by accountants, lawyers, or physicians.

At least 50 percent of the CAPCO's investments in qualified businesses must be in "early stage technology businesses" involved in activities related to developing initial product or service offerings. If those investment benchmarks are not met, the CAPCO may be decertified. Decertification could result in the forfeiture or recapture of some, or all, of the premium tax credits earned by certified investors. The Department of Banking and Finance is required to review each CAPCO annually to verify compliance with the Act and to advise the CAPCO as to the eligibility status of its qualified investments.

Distributions

Before a CAPCO may make any distribution to its equity holders, other than a “qualified distribution,” the CAPCO must have invested 100 percent of its certified capital in qualified investments. A “qualified distribution” of up to 2.5 percent of the CAPCO’s certified capital may be made to equity holders for the costs and expenses of forming, managing, and operating the company, plus reasonable and necessary fees for professional services, such as legal and accounting services. Payments of principal and interest to debt holders may be made without restriction.

A CAPCO is required to pay to the Department of Revenue 10 percent of the portion of distributions to all certified investors (insurers) and equity holders that exceed the CAPCO’s original certified capital (which includes both equity and debt investments) and any additional capital contributions to the CAPCO.

Allocation of Premium Tax Credits

OTTED is responsible for allocating premium tax credits to certified investors that apply and submit specified documentation. The aggregate amount of premium tax credits that may be allocated for the life of the program is capped at \$150 million. On an annual basis, a CAPCO must file a report with OTTED and the office and the Department of Banking and Finance. The report must detail the investments that the CAPCO has received from certified investors and the investments it has made in qualified businesses, including the number of jobs created or retained and the average wages of such jobs. The Department of Banking and Finance must conduct an annual review of each CAPCO to determine if it is abiding by the requirements of certification, and the Department of Revenue may audit and examine the records of CAPCOs and certified investors.

Impact of Florida's CAPCO Program to Date

Following program initiation in 1999, the capital commitments from state insurance companies exceeded the \$150 million limit of tax credits. According to a Washington Economic Group study published May 7, 2001, CAPCO-funded businesses directly generated 321 new jobs and indirectly led to another 532 jobs since program initiation in 1999. The study reported that in 2000, the average salary for an employee of a CAPCO-funded company was \$48,800. Survey results indicated that many CAPCO-funded businesses consider the CAPCO funds important in their successful efforts to obtain additional, follow-on, capital from private investors.

According to CAPCO annual reports filed with OTTED as of December 31, 2001, CAPCO funded businesses employ an estimated 588 Floridians with an average salary of \$53,097.

PricewaterhouseCoopers *Shaking the Money Tree – Venture Capital Trends in Florida* reports that the CAPCO program has facilitated venture capital investing in Florida.

“Traditionally, almost all of the venture capital invested in Florida-based companies has come from out of state. Venture funds in New York and Boston in particular have been adept at identifying promising startups in various Florida markets and quietly making their investments. . . This is beginning to change, though. . . . Also spurring this growth was the creation of the Florida “CapCo” (Certified Capital Company) program by the Legislature in 1999.”

C. EFFECT OF PROPOSED CHANGES:

Definitions

Under the current statute, the definition of "affiliate of an insurance company" includes any person directly or indirectly controlling the power to vote 10 percent or more of the outstanding voting securities or other ownership interest of the insurance company, or any person 10 percent or more of whose interest is directly or indirectly beneficially owned, controlled or held with the power to vote by the insurance company. The bill would change the 10 percent or more language to 15 percent or more in both circumstances.

The bill would change the definition of "certified capital company" to require the CAPCO to receive investments of certified capital from two or more **unaffiliated** certified investors. This provision is intended to prevent a single certified investor from controlling a CAPCO.

The bill would change the definition of "early stage technology business" to include a business that is **either** involved in activities related to developing initial product or service offerings **or** less than two years old with less than \$3 million in annual revenues for the fiscal year immediately preceding the initial investment by the CAPCO. This change would allow a business that meets all of other requirements, except for the less-than two-year requirement, to be deemed an "early stage technology business." This change recognizes that some businesses, such as those engaged in research and development, may be formally incorporated for a substantial period of time before business is actually transacted. Such businesses, which otherwise meet the statutory requirements, will not be precluded from being a CAPCO merely because they have been in existence for more than two years.

The bill would change the definition of "qualified business" to include within the definitions of "headquartered" and "principal business operations" the requirement that 75 percent of the business' employees be located within Florida. This change is intended to ensure that Florida, and Florida workers, are the primary beneficiaries of the Act.

The bill would change the definition of "qualified business" to exclude certain types of businesses. A business with no historical revenues and no specific business plan or purpose, or that has indicated that its business plan is solely to engage in a merger or acquisition with another company or entity, would be excluded from the definition. Any company that has a strategic plan to grow through the acquisition of firms with substantially similar business that would result in the planned net loss of Florida-based jobs over a 12-month period after the acquisition also would be excluded.

The bill would change the definition of "qualified distribution" to include the payment of reasonable costs and expenses, including but not limited to professional fees and expenses, associated with forming and syndicating the CAPCO, if such costs or expenses would not be paid to a certified investor. Also, qualified distributions could not equal or exceed 50 percent of the total certified capital allocated to the CAPCO. The bill would allow for payment of reasonable costs of managing and operating the CAPCO, in an amount not exceeding 5 percent of the certified capital in any year.

The bill would change the definition of "qualified investment" to exclude three types of investments: (1) certain investments with repayment periods of less than 12 months from the initial investment; (2) certain follow-up or add-on investments; and (3) investments in a qualified business or affiliate of a qualified business that exceeds 15 percent of certified capital.

The bill would add definitions for "Program One" and "Program Two" to distinguish between the \$150 million in premium tax credits available under Program One and from the proposed additional \$300 million in tax credits that would be available under Program Two.

Certification and Decertification

The bill would establish November 1, 2002 as the deadline by which businesses seeking certification as a "certified capital company" under Program Two must file a verified application. The bill would also require businesses seeking certification to submit "copies of any offering materials used or proposed to be used by the applicant in soliciting investments of certified capital from certified investors." The bill would change the financial requirements for applicants and would require an applicant to, within 90 days before it files its application, document that it has a *net worth*, rather than "net capital," of at least \$500,000 and provide a verified audit report of its financial condition and history.

The bill would establish December 31, 2002 as the deadline for the Department of Banking and Finance to grant or deny certification to a Program Two applicant.

The bill would establish as one of the factors that may be considered by the Department of Banking and Finance in determining whether to certify a business is whether "[t]he applicant's proposed method of doing business and raising certified capital as described in its offering materials and other materials submitted to the department conforms with the requirements of this section." This provision would allow the Department to make an initial analysis of the CAPCO's business plan prior to its certification to ensure that a CAPCO is likely to be in compliance with Departmental regulations.

The bill would delete the requirement that a CAPCO file a copy of its certification with OTTED.

The bill would prohibit an insurance company or its affiliates from owning or controlling 15 percent or more of the equity interests in a CAPCO or from having the right to participate in 15 percent or more of the profits of a CAPCO. This provision would supplement the existing prohibitions on an insurance company's management, control or direction of a CAPCO's investments.

The bill would authorize the Department of Banking and Finance to impose a \$5,000 late fee if a CAPCO fails to pay the annual renewal fee on or before January 31 of each year. The bill also would require each CAPCO to file audited financial statements with the Department on or before April 30 of each year.

Investments by CAPCOs

The bill would set the schedule for the investments to be made by a CAPCO under Program Two. To remain certified, a Program Two CAPCO would have to invest at least: 20 percent of its certified capital in qualified investments by December 31, 2004; 30 percent of its certified capital in qualified investments by December 31, 2005; 40 percent of its certified capital in qualified investments by December 31, 2006; and 50 percent of its certified capital in qualified investments by December, 2007. As with Program One, at least 50 percent of such qualified investments would have to be invested in early stage technology businesses.

The bill would change existing language providing that all capital not invested in qualified investments must be held in financial institution or a registered broker-dealer, to authorize investment of such capital in certain obligations issued by an insurance company.

The bill would eliminate language limiting a carry-forward credit allowance through the year 2017. With such a change, premium tax credits under Program One and Program Two would have no expiration date.

Annual Tax Credit; Maximum Amount; Allocation Process

The bill would limit to \$300 million the total tax credits that may be allocated by OTTED under Program Two and would limit to \$5 million the tax credits that can be earned per year under Program Two. An insurer could earn a vested credit against premium tax liability in an amount equal to 100 percent of the certified capital invested in the CAPCO, but the insurer could use no more than 10 percent of its tax credit annually. The bill would also establish a March 15, 2003, deadline for a Program Two CAPCO to apply to OTTED for an allocation of premium tax credits to its potential investors. The bill would require OTTED to notify each Program Two CAPCO of its share of the total premium tax credits available on or before April 1, 2003. The bill would prohibit CAPCOs from submitting premium tax allocation claims on behalf of certified investors that total an amount in excess of the total appropriated by the Legislature for the program. The bill would limit to \$7.5 million the amount of certified capital for which premium tax allocation claims may be filed on behalf of any certified investor and its affiliates by one or more CAPCO under Program Two.

The bill would establish a formula for determining the premium tax credits that may be allowed to any one certified investor under Program Two in the event the total amount of capital committed by all certified investors exceeds the total credits that may be awarded under Program Two.

The bill would authorize the Department of Banking and Finance to adopt rules to allocate the remainder of the \$300 million allocated tax credits in the event that less than \$300 million in certified capital is raised in the initial allocation period of Program Two. Existing language in the Act provides such authority for to the \$150 million in tax credits authorized for Program One.

The bill would require OTTED to issue a certification letter for each certified investor, showing the amount invested in the CAPCO under each program, and to require the corresponding CAPCO to attest to the validity of the letter.

Annual Tax Credit; Claim Process

The bill would require each CAPCO to file a report on or before December 31 each year providing specific information related to its financial and employment activity for the preceding calendar year. Such report would be filed by each CAPCO on or before January 31 of each year.

Requirement for 100 Percent Investment; State Participation

The bill would conform the language in the Act applicable to Program One to the extent to accommodate Program Two.

This bill would require a CAPCO to have first invested an amount cumulatively equal to 100 percent of the certified capital raised under Program one or Program Two before it may make qualified distributions to its equity holders. The bill would also require a CAPCO to pay 10 percent of the portion of any excess distribution to the Department of Revenue if the total of its distributions, other than qualified distributions, exceeds the aggregate sum of the certified capital raised by the CAPCO. The

bill would limit the total amount paid to the Department of Revenue by a CAPCO to the total tax credits used by all certified investors in the CAPCO.

This bill would require forfeiture of premium tax credits when a CAPCO fails to continue to meet CAPCO certification requirements.

Date of Effectiveness

The bill provides that the amendments to the Act it proposes would take effect July 1, 2002.

D. SECTION-BY-SECTION ANALYSIS:

N/A

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The fiscal impact of this bill has yet to be reviewed by the Revenue Estimating Conference.

2. Expenditures:

The fiscal impact of this bill has yet to be reviewed by the Revenue Estimating Conference.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

N/A

2. Expenditures:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Assuming that the proposed tax credits (\$300 million over 10 years) are fully subscribed, certified investors under Program Two would be entitled to take tax credits of \$5 million a year against their insurance premium tax filings beginning with the filings made in 2005 for the calendar year 2004. A certified investor may carry-forward any unused tax credits indefinitely.

Except for non-compliance with the filing and fee payment provisions of the Act, the bill would not impose any additional costs on the private sector. Businesses seeking certification as a CAPCO would continue to pay the existing \$7,500 application fee and the existing \$5,000 annual renewal fee.

Expansion of the CAPCO program could result in additional venture capital investing and high-wage job creation in Florida-based technology businesses. Small businesses would have access to additional sources of venture capital for start-up or expansion.

D. FISCAL COMMENTS:

An certified investor would earn a vested tax credit against premium tax liability of 100 percent of the certified capital invested in the CAPCO, but could use no more than 10 percent of the tax credit annually.

The Department of Banking and Finance would be authorized to collect a filing fee of \$7,500 and a renewal fee of \$7,500, impose a \$5,000 late fee for late payment of the annual renewal certification fee, and levy a fine up to \$50,000 if a certified investor does not invest the full amount of certified capital allocated to it by the Department.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

The bill would not require counties or municipalities to expend funds, nor would it require counties or municipalities to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

The bill would not reduce the authority that municipalities or counties have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

The bill would not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

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VII. SIGNATURES:

COMMITTEE ON COMMITTEE ON INFORMATION TECHNOLOGY:

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