

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 1467 Capital Formation  
**SPONSOR(S):** Grant and others  
**TIED BILLS:** HB 1469 **IDEN./SIM. BILLS:** SB 2668

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| REFERENCE   | ACTION | ANALYST   | STAFF DIRECTOR |
|---|--------|-----------|----------------|
| 1) Economic Development, Trade & Banking Committee                |        | Olmedillo | Carlson        |
| 2) Transportation & Economic Development Appropriations Committee |        |           |                |
| 3) Commerce Council   |        |           |                |
| 4) _____  |        |           |                |
| 5) _____  |        |           |                |

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### SUMMARY ANALYSIS

This bill creates the Florida Capital Formation Act (Act), which is designed to increase the amount of venture capital investment in Florida.

The bill creates the following:

- **Florida Capital Investment Trust**, a state beneficiary public trust to hold contingent tax credits as a guarantee for investments made under the Act. Tax credits may only reduce tax liabilities for sales and use tax, corporate income tax, insurance premium tax and tax on wet marine and transportation insurance.
- **The Florida Opportunity Fund Management Corporation**, a non-profit corporation, which will organize the Florida Opportunity Fund, select an early stage venture capital investment fund allocation manager and manage the business affairs of the Florida Opportunity Fund.
- **The Florida Opportunity Fund**, which shall invest on a funds-of-funds basis emphasizing investment in seed capital and early stage venture capital funds focusing on opportunities in Florida.

The bill appropriates \$750,000, for fiscal year 2006-2007 from the General Revenue Fund to the Florida Capital Investment Trust to be used for startup activities. The bill also reserves \$75 million in tax credits as a guarantee of investments made under the Act.

This bill provides an effective date of July 1, 2006.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

Limited Government -- The bill creates the Florida Capital Investment Trust, the Florida Opportunity Fund Management Corporation, and the Florida Opportunity Fund. The bill provides the Department of Revenue (DOR) rule making authority to implement provisions of this Act.

The bill appropriates \$750,000, for the fiscal year 2006-2007, from the General Revenue Fund to the Florida Capital Investment Trust to be used for startup activities necessary to implement the provisions of this Act.

#### B. EFFECT OF PROPOSED CHANGES:

##### **Present Situation:**

##### **THE VENTURE CAPITAL INDUSTRY--AN OVERVIEW**

Venture capital is money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors. Venture capital is an important source of equity for startup companies.<sup>1</sup>

Venture capitalists generally:

- Finance new and rapidly growing companies;
- Purchase equity securities;
- Assist in the development of new products or services;
- Add value to the company through active participation;
- Take higher risks with the expectation of higher rewards;
- Have a long-term orientation<sup>2</sup>

Venture capitalists actively work with the company's management by contributing their experience and business savvy gained from helping other companies with similar growth challenges.

Venture capitalists mitigate the risk of venture investing by developing a portfolio of young companies in a single venture fund.

A venture capitalist may invest before there is a real product or company organized (so called "seed investing"), or may provide capital to a company in its first or second stages of development known as "early stage investing."

Some organizations may include government affiliated investment programs that help startup companies either through state, local or federal programs. One common vehicle is the Small Business Investment Company or SBIC program administered by the Small Business Administration, in which a venture capital firm may augment its own funds with federal funds and leverage its investment in qualified investee companies.

##### **Term of Investment**

Depending on the investment focus and strategy of the venture firm, it will seek to exit the investment in the portfolio company within three to five years of the initial investment. While the initial public offering may be the most glamorous and heralded type of exit for the venture capitalist and owners of the

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<sup>1</sup> Available at <http://www.nvca.org/def.html>, last viewed March 27, 2006.

<sup>2</sup> Id.

company, most successful exits of venture investments occur through a merger or acquisition of the company by either the original founders or another company.

### Management Fees

As an investment manager, the general partner will typically charge a management fee to cover the costs of managing the committed capital.

### **STATE VENTURE CAPITAL IN FLORIDA**

Venture capital refers to the early-stage financing of new companies with high growth potential. Venture capital investments typically have several characteristics, including an investment in a start-up or expansion-oriented company that has a higher level of risk than is typically associated with traditional bank lending activities; equity participation in the business by the venture capitalist; long-term investments with a 5- to 10-year time horizon; and an established mechanism for the payout of the venture capitalist at the end of that time period.<sup>3</sup>

Enterprise Florida, Inc. (EFI) reports that in Florida, total venture capital spending was more than \$555 million for 114 deals in 2003 and 2004.<sup>4</sup> The EFI website lists 27 venture capital firms that have headquarters in Florida.<sup>5</sup>

EFI also reports that since the late 1990's, venture capital investment in Florida has fallen sharply both in absolute dollar terms and as a share of the U.S. total. Despite being the 4th most populous state, Florida ranks 13th in the U.S. in terms of venture capital investment in 2004. In 2004 Florida accounted for only \$300 million, or 1.42% of the total venture capital funding in the U.S.<sup>6</sup>

### **State Investments in Venture Capital**

Over the past decade, a number of states have adopted programs targeting the formal venture capital industry.<sup>7</sup> These programs include:

- Government-funded and managed venture capital funds (VCFs);
- Requiring public-sector pension funds to make venture capital investments (either directly or through VCFs);
- Tax credits for private investment in VCFs; and
- Government investment or government-guaranteed investment in private VCFs.<sup>8</sup>

### **Effects of Proposed Changes:**

This bill creates the Florida Capital Formation Act (Act), and provides legislative findings and intent relating to the Act.

### **Definitions**

The bill provides the following definitions:

- "Board" means the board of trustees of the Florida Capital Investment Trust.
- "Certificate" means a contract between the trust and a designated investor evidencing the terms of a guarantee or incentive granted to a designated investor.

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<sup>3</sup> OPPAGA Report on the Cypress Equity Fund, Report No. 98-33. For more information, see the National Venture Capital Association (NVCA) website at <http://www.nvca.org/def.html>. The NVCA is a trade association that represents the U.S. venture capital industry. It is a member-based organization, which consists of venture capital firms that manage pools of risk equity capital designated to be invested in high growth companies.

<sup>4</sup> <http://www.eflorida.com/businessadvantages/1/venturecapital.asp?level1=29&level2=159>

<sup>5</sup> Id.

<sup>6</sup> Enterprise Florida, Inc.

<sup>7</sup> EFI reports that 39 states have adopted programs to deliver or facilitate the formation of local seed and venture capital resources. Id. at 3.

<sup>8</sup> See Daniel Sandler, *State Venture Capital Programs*, and *Venture Capital and Tax Incentives: A Comparative Study of Canada and the United States* (Toronto: Canadian Tax Foundation, 2004).

- "Corporation" means the Florida Opportunity Fund Management Corporation created under the bill.
- "Designated investor" means a person, other than the board, who purchases an equity interest in the Florida Opportunity Fund or is a party to a certificate or who is a lender to the Florida Opportunity Fund and is a party to a certificate.
- "Florida Capital Investment Trust" or "trust" means a state beneficiary public trust created under the bill.
- "Florida Opportunity Fund" or "fund" means the private, for-profit limited partnership or limited liability company in which a designated investor purchases an equity interest or to which a designated investor extends credit.
- "Tax credit" means a contingent tax credit issued to offset tax liabilities imposed by this state, provided the proceeds of such tax are payable to the General Revenue Fund. A tax credit is not eligible to offset tax liabilities imposed by a political subdivision within this state.

### **Florida Capital Investment Trust**

This bill creates the Florida Capital Investment Trust (Trust) as a state beneficiary public trust.

The bill creates a board of trustees (Board of Trustees) as follows:

- Five voting trustees and two nonvoting ex officio trustees.
  - Three voting trustees appointed by the Governor.
  - One voting trustee appointed by the President of the Senate.
  - One voting trustee appointed by the Speaker of the House of Representatives.
  - One nonvoting ex officio trustee shall be the designee of Enterprise Florida, Inc., and serve at its pleasure.
  - One nonvoting ex officio trustee shall be the designee of the Florida Research Consortium and serve at its pleasure.

The bill establishes that the exercise of the powers of the Board of Trustees is deemed to be the performance of essential public purposes.

The Governor shall appoint one trustee to a term ending April 30, 2007 and two trustees ending April 30, 2009. The Senate and the House shall each appoint trustees to terms ending April 30, 2008. Thereafter, each voting trustee shall be appointed for a 3-year term. Ex officio trustees serve annual terms and may be reappointed. A trustee's term ends on April 30 of his or her term expiration year. Trustees whose terms have expired may continue to serve until their replacements have been duly appointed and vacancies shall be filled in the same manner as original appointments.

Trustees must be selected based upon expertise and competence in the supervision of early stage investment managers, the fiduciary management of funds, the administration and management of a publicly listed company, or experience and competence in public accounting, auditing, and fiduciary responsibilities. The trustees will serve without compensation in the form of fees, per diem, or salary. Trustees may receive compensation or reimbursement for direct expenses, mileage, and other travel expenses related to the performance of their duties, pursuant to s. 112.061, F.S. Trustees may not have an interest in any entity to which a certificate is issued.

### Powers and Limitations

The bill grants the Board of Trustees broad powers to carry out its purpose under the Act, including engaging consultants, expending funds, investing funds, contracting, bonding or insuring against loss, providing guarantees or other incentives, holding transferable tax credits, selling tax credits, or entering into any financial or other transaction.

In the event the Board of Trustees elects to hire employees, the bill requires such employees to be selected based on their knowledge and leadership in the field for which the person performs services for the Board of Trustees.

The bill requires the Board of Trustees, in conjunction with Department of Revenue (DOR) to develop a system for registration of tax credits received and transferred by the Trust. In addition, the Board of Trustees shall develop a documentation system to verify that claimed tax credits are valid.

The bill authorizes the Board of Trustees to charge fees for its guarantees to designated investors or for other services such that its operations may be conducted without subsequent legislative appropriation.

The Board of Trustees meetings shall be subject to the provisions of s. 286.011, F.S., requiring all meetings at which official acts are to be taken to be public at all times and requiring the Board of Trustees to provide reasonable notice of all such meetings. Nevertheless, the bill provides that information on securities acquired and held by the Florida Opportunity Fund shall be maintained in confidence. **This appears to be a public records exemption. Please see Drafting Issues or Other Comments.**

#### Issuance of Credits

The bill authorizes the issuance and transfer of credits to the Trust in the amount of \$75 million. However, the bill limits the transfer of tax credits to \$20 million for use in any single state fiscal year.

The Board of Trustees may transfer and sell tax credits solely for the purpose of fulfilling, in whole or in part, any certificate obligation issued by the Board of Trustees and such tax credits may only be transferred in increments of \$100,000. Once the Board of Trustees transfers any tax credit, it shall immediately notify, in writing, the Governor, the President of the Senate, the Speaker of the House of Representatives and DOR. The Board of Trustees shall also be notified immediately of any transfers of tax credits by persons or businesses other than the Board of Trustees and shall notify DOR, in writing, of such transfers.

Tax credits may only serve to reduce tax liabilities imposed by chapter 212 (Sales and Use Tax), chapter 220 (Corporate Income Tax), s. 624.509 (insurance premiums taxes), or s. 624.510 (Tax on wet marine and transportation insurance). The bill specifies that an insurance company claiming a credit against premium tax liability under this section shall not be required to pay any additional retaliatory tax levied pursuant to s. 624.5091 as a result of claiming such credit.

Any original sale of tax credits by the board shall be by competitive bidding unless the sale is for the full face value of the credits. The use of transferred tax credits may not occur prior to July 1, 2011 or after July 1, 2036.

The bill grants DOR, in conjunction with the Board of Trustees, rule making authority to set the manner and form of documentation required to claim tax credits granted or transferred under this Act, and the requisites to prove an affirmative showing of qualification for such tax credits.

#### **Florida Opportunity Fund Management Corporation**

At the request of the Board of Trustees, Enterprise Florida, Inc. shall facilitate the creation of the Florida Opportunity Fund Management Corporation (Fund Corporation), as a private not-for-profit corporation. Enterprise Florida, Inc. shall be the Fund Corporation's sole member. The bill provides that the Fund Corporation is not a public corporation or an instrumentality of the state. The Fund Corporation shall have all powers granted under its organizational documents and shall indemnify directors to the broadest extent permissible under the laws of Florida.

#### Board of Directors

Enterprise Florida, Inc.'s vice chair shall select from its board of directors a five person-appointment committee (Committee). The Committee shall select five initial members to the board of directors (Board of Directors) for the Fund Corporation.

The initial members of the Board of Directors shall include persons who have expertise in the areas of the selection and supervision of early stage investment managers or in the fiduciary management of investment funds and other areas of expertise as deemed appropriate by the Committee. Members of the Board of Directors shall be subject to any restrictions on conflicts of interest specified in the organizational documents and shall have no interest in any venture capital investment fund allocation manager selected by the Fund Corporation pursuant to this Act or in any investment made by the Florida Opportunity Fund.

The Board of Directors shall be compensated for direct expenses and mileage pursuant to s. 112.061 but shall not receive a fee or salary for service as directors. The Fund Corporation serves as a general partner or manager of the Fund and may charge a management fee on assets under management in the Fund, only to pay for reasonable and necessary costs.

#### Purpose

The purposes of the Fund Corporation shall be to organize and manage the Florida Opportunity Fund.

The Fund Corporation shall conduct a national solicitation for investment plan proposals from qualified venture capital investment fund allocation managers for the raising and investing of capital by the Fund Corporation. Proposals shall address the following in relation to the applicant:

- The level of experience;
- The quality of management;
- The investment philosophy and process;
- The probability of success in fundraising;
- The prior investment fund results; and
- A plan for achieving the purposes of the bill.

The Fund Corporation shall only select a manager with expertise in the management and fund allocation of investment in venture capital funds.

#### **The Florida Opportunity Fund**

The bill directs the Fund Corporation to create the Florida Opportunity Fund (Fund), upon request by the Board of Trustees, to be organized and incorporated as a for-profit limited liability partnership or limited liability corporation under the laws of Florida. The Board of Trustees, the Fund Corporation or the Fund may contract with Enterprise Florida, Inc. for provision of services necessary for continuing operations.

The Fund shall invest on a funds-of-funds basis and emphasize investment in seed capital and early stage venture capital funds focusing on opportunities in Florida. While not precluded from investing in funds with a wider geographic spread of portfolio investment, the Fund shall require an investment fund to have a record of investment in Florida, be based in Florida, or have an office in Florida staffed with a full-time, professional venture investment executive to be eligible for investment.

The investments by the Fund shall be on partnership interests in private venture capital funds and not in direct investments in individual businesses. The Fund shall invest in venture capital funds with experienced managers or management teams with demonstrated expertise and a successful history in the investment of early stage venture capital funds. The Fund may invest in newly created early stage venture capital funds as long as the manager or management teams of the funds have experience, expertise, and a successful history in the investment of venture capital funds. The Fund may not invest in a fund unless that fund has raised capital from other sources in an amount greater than the investment of the Fund. The Fund Corporation and its partners or shareholders may negotiate any and all terms and conditions for its investments, including draw back of management fees and other provisions that maximize investment in seed and early stage companies based in Florida.

Investments by designated investors in the Fund shall be deemed permissible investments for state-chartered banks and for domestic insurance companies under applicable state law.

If the fund is liquidated or has returned all capital to designated investors in accordance with contractual agreements, or the guarantee capacity of the trust, at the sole discretion of the board, is sufficient for additional certificates, new funding of the Florida Opportunity Fund may be implemented for subsequent venture capital fund-of-funds investments. If the board takes exception to an additional funding, such additional funding may only be implemented without the benefit of certificates from the board.

### Fees

The bill authorizes the Board of Trustees to charge fees for its guarantees to designated investors or for other services such that its operations may be conducted without subsequent legislative appropriation. The bill also authorizes the Fund Corporation to charge a management fee on assets under management in the Fund. In addition, Managers may charge a management fee to the Fund.

### Annual Report

The bill requires that the Board of Trustees provide an annual report on the activities conducted by the Fund to the Governor, the President of the Senate and the Speaker of the House of Representatives. The report shall include the following:

- A copy of the independent audit of the Fund;
- A valuation of the assets of the Fund;
- A review of the progress of the Manager in implementing the fund's investment plan;
- The benefits to the state resulting from this program;
- The number of businesses created and their associated industry;
- The number of jobs created; and
- A description of any sale of tax certificates and any sale of tax certificates that is reasonably anticipated by the Board of Trustees to meet its certificate obligations.

The bill provides that DOR may share information relative to tax credits claimed under this Act to the Board of Trustee of the Trust in the conduct of the Trust's official business.

The bill includes tax credits transferred or sold within the priority list of applied credits against certain taxes and within the order or taking credits or deductions against the insurance premium tax.

### **Appropriations**

The bill appropriates \$750,000, for the fiscal year 2006-2007, from the General Revenue Fund to the Florida Capital Investment Trust to be used for startup activities necessary to implement the provisions of this Act.

#### **C. SECTION DIRECTORY:**

Section 1. Creates Part X of chapter 288, including ss. 288.9621, 288.9622, 288.9623, 288.9624, 288.9625, 288.9626, 288.9627 and 288.9628, F.S., relating to the Capital Formation Act.

Section 2. Amends s. 213.053, F.S., to authorize the Department of Revenue to provide tax credit information to the Board of Trustees of the Florida Capital Investment Trust.

Section 3. Amends s. 220.02, F.S., to include tax credits in a list of credits and in a priority order.

Section 4. Amends s. 624.509, F.S., to include tax credits in a priority order of credits and deductions against premium tax.

Section 5. Provides an appropriation.

Section 6. Provides an effective date of July1, 2006.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

#### 1. Revenues:

The bill authorizes the transfer of up to \$20 million per year of contingent tax credits as a guarantee for investments made under the Act. The total value of credits that may be claimed is \$75 million. This may result in a reduction of state revenues of up to \$20 million per year if transferees claim such credits.

#### 2. Expenditures:

The bill appropriates \$750,000, for the fiscal year 2006-2007, from the General Revenue Fund to the Florida Capital Investment Trust to be used for startup activities necessary to implement the provisions of this Act.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

#### 1. Revenues:

None.

#### 2. Expenditures:

None.

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

### D. FISCAL COMMENTS:

None.

## III. COMMENTS

### A. CONSTITUTIONAL ISSUES:

#### 1. Applicability of Municipality/County Mandates Provision:

The bill does not require a municipality or county to spend funds or to take any action requiring the expenditure of funds, does not reduce the county's authority to raise revenue, and does not reduce the percentage of a state tax shared with counties or municipalities.

#### 2. Other:

None.



**B. RULE-MAKING AUTHORITY:**

The bill grants DOR, in conjunction with the Board of Trustees, rule making authority to set the manner and form of documentation required to claim tax credits granted or transferred under this Act, and the requisites to prove an affirmative showing of qualification for such tax credits.

**C. DRAFTING ISSUES OR OTHER COMMENTS:**

Subsection (2) of new s. 288.9625, F.S. provides that the board may transfer and sell tax credits solely for the purpose of fulfilling, in whole or in part, any certificate obligation issued by the "board". This language may conflict with the power of the Fund Corporation, not the Board of Trustees, to enter into certificate obligations. As a result, it appears that, although the Fund Corporation may enter into contracts for certificate obligations with Managers, it does not have the power to grant tax credits to that Manager.

Also, this subsection states that the Board of Trustees shall be notified immediately of any transfers of tax credits by persons or businesses other than the Board of Trustees and shall notify DOR, in writing, or such transfers. The transfer of tax credits appears to be only under the authority of the Trust, hence, this language conflicts with such authority.

Subsection (6) of new s. 288.9624 appears to create a public records exemption for information on securities held by the Florida Opportunity Fund. A public records exemption must be created pursuant to s. 24(c), Art. I of the State Constitution in a separate bill.

**IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES**