

**ARIZONA STATE SENATE**  
*Phoenix, Arizona*

FACT SHEET FOR S.B. 1401

**Arizona capital formation incentives**

**Purpose**

Establishes the Arizona Venture Capital Access Program to assist in the formation of new businesses and the expansion of existing businesses with the use of premium tax credits for insurance companies and establishes the Arizona Capital Investment Program to generate capital for investment in private seed and venture capital partnerships with the use of transferable income tax credits. Makes an unspecified appropriation in FY 2004-2005 from the state General Fund to the Department of Commerce.

**Background**

A recent report issued by the National Governors' Association indicated that most states have adopted programs to encourage the formation of local seed and venture capital resources using varied strategies. One strategy is the Certified Capital Company (CAPCO) model where states allow insurance companies to claim premium tax credits for qualified investments into certified CAPCO funds. The tax credits generate private venture capital to be invested in that state. In 1983, Louisiana became the first state to adopt a CAPCO-type model and other states such as Missouri, New York, Florida, Wisconsin, Colorado and Texas have also enacted CAPCO models.

S.B. 1401 creates a CAPCO model in Arizona. It establishes the Arizona Venture Capital Access Program to assist in the formation of new businesses and the expansion of existing businesses that create employment in Arizona by providing an incentive for insurance companies to invest certified capital in certified capital companies. A credit is offered against an insurance company's premium tax equal to 100 percent of the investment. The premium tax credits may be claimed in the third year after the investment is made. The legislation also establishes the Arizona Capital Investment Program in which a designated investor group (Group) is selected to generate capital using income tax credits and to invest the capital in a private fund that will be authorized to make investments in private seed and venture capital partnerships or entities. The Group may use the credits only as security for monies borrowed and, on default, is transferred from the Group to the lender and the lender may use the credit as a payment or prepayment of its income tax liability.

There is an undetermined negative fiscal impact to the state General Fund due to the income and premium tax credits. The transferable income tax credits are allowed from July 1, 2007 through June 30, 2032 and are limited to a total amount of \$100

million in the aggregate and a total of \$10 million in any calendar year. The premium tax credits are available after January 1, 2005 and the tax credits for all certified investors may not exceed \$15 million in any fiscal year. Additionally, a blank appropriation is made from the state General Fund in FY 2004-2005 to the Department of Commerce to administer the programs.

## Provisions

# *Designated Investor Group of the Arizona Capital Investment Program*

1. Requires the Department of Commerce (DOC) to solicit investment plans from qualified investor groups and to select and certify as the designated investor group the group DOC considers to be the best qualified to generate capital and to invest the capital in a private fund that will be authorized to make investments in private seed and venture capital partnerships or entities.
2. Requires the investments to be made in a manner that will mobilize a wide variety of equity capital and near-equity capital to, among other requirements, serve the needs of entrepreneurs in Arizona and expand the private seed and venture capital industry of this state.
3. Specifies what must be included in the investment plans.
4. Requires the manager of the investor group to be a resident of Arizona who has experience in designing, implementing and managing state sponsored seed and venture capital investment programs and in capital formation.
5. Prohibits the manager from being a commercial lender.
6. Requires the designated investor group to mobilize at least \$1 of investment in business projects in Arizona for every \$1 invested in seed and venture capital partnerships or entities and to have goals of mobilizing at least \$2 of investment for every \$1 invested.
7. Requires at least 25 percent of the designated investor group's investment capital to be allocated to serve businesses and projects in rural areas of Arizona.
8. Requires at least 15 percent of the designated investor group's investment capital to be allocated for investment in Arizona small business investment companies or small business companies in formation, as defined by federal law, and with a primary investment strategy of investing in the formation of manufacturing enterprises on or near Indian reservations in Arizona.

9. Requires the designated investor group to publish an annual report that describes its activities, reviews its progress and includes its annual audit prepared by a certified public accountant. Requires the annual report be submitted to the Governor, Legislature and DOC.

## *Venture Certificates*

10. Requires DOC to enter into a contract, known as the venture certificate, with the designated investor group that is binding and may not be modified, terminated or rescinded.

11. Allows DOC to make any contract, execute any document, perform any act or enter into any financial or other transaction necessary to carry out the Arizona Capital Investment Program.

12. Requires the venture certificate to include a formula for determining rates of return on investment and stipulates venture capital tax credits may not be claimed or used except according to the terms of the venture certificate.

13. Requires DOC to state the schedules and formulas by which any shortfalls in returns of invested capital or returns on invested capital may be computed, and thereby the amount of the credits that may be claimed.

## *Income Tax Credits*

14. Allows the designated investor group to use transferable income tax credits as security for monies borrowed for the purpose of capital investment for taxable periods beginning July 1, 2007 through June 30, 2032, to be used as payment or prepayment of any income tax liability of the holder.

15. Requires DOC to determine the amount of the credits and the year it may first be claimed.

16. Requires the first year a credit may be claimed to be at least three years after the capital investment.

17. Specifies the amount of the credit is equal to an amount sufficient to offset any shortfalls occurring in the scheduled returns to the designated investor group of invested capital and returns on invested capital.

18. Limits the amount of the credits to a total of \$100 million in the aggregate and to a total of \$10 million in any calendar year that may be redeemed or used as prepayment in lieu of tax.

19. Requires DOC, with the assistance of the Department of Revenue (DOR), to develop a system for registering tax credits allowed or transferred and specifies the requirements of the system.
20. Stipulates taxpayers are entitled to rely on the registration and verification system.
21. Stipulates venture capital tax credits are not considered to be a security under the Uniform Commercial Code.
22. Requires DOC to submit an annual report on the use of the tax incentives on or before the fifth day of each regular legislative session to the Governor, Legislature, Secretary of State, Arizona State Library, Archives and Public Records and to any member of the public requesting a copy.
23. Stipulates the records and documents generated by DOC and DOR are subject to public records law and stipulates proprietary information of any investor group or other person and any information relating to income tax credits issued are confidential unless disclosure consent is given.
24. Stipulates taxpayer information regarding venture capital tax credits is confidential.
25. Terminates the Arizona Capital Investment Program on July 1, 2014 and stipulates the termination does not affect the validity or effect of any tax credits issued.

## ***Arizona Venture Capital Access Program***

26. Establishes the Arizona Venture Capital Access Program (VCA Program) to assist the formation of new businesses and the expansion of existing businesses that create employment in Arizona by providing an incentive for insurance companies to invest in certified capital companies.
27. Requires DOC to prescribe application procedures for a partnership, corporation, trust or limited liability company to apply to DOC to become a certified capital company.
28. Requires an applicant's capitalization to be at least \$500,000 in the form of unencumbered cash, marketable securities or other liquid assets.
29. Requires at least two of the applicant's principals or managers of the applicant's funds to have at least two years' experience in the venture capital industry and to be residents of Arizona and primarily located in an office of the applicant in Arizona.
30. Prohibits the principals or managers from being commercial lenders.
31. Requires DOC to make a determination on the certification of a capital company applicant in the order they are submitted within 30 days of receiving the application.

32. Requires, if more than one application is received on the same date, DOC to review them simultaneously except if the application is incomplete or DOC requests additional information.
33. Requires DOC to state, in detail, the grounds for a denial of certification of a capital company and any suggestions for removing the grounds.
34. Allows the applicant to submit an amended application within 15 days after receiving a denial from DOC and requires DOC to approve or deny the amended application within 15 days of receiving the amended application.
35. Terminates the VCA Program on July 1, 2014.

## ***Limited Ownership***

36. Prohibits an insurance company or an affiliate from directly or indirectly owning ten percent or more of the equity interests of a certified capital company, managing a certified capital company or controlling the direction of investments for a certified capital company.

37. Stipulates the prohibition does not prevent a certified investor, insurance company or any other party from its legal rights and remedies, including interim management of a certified capital company if the company defaults on its obligation.

38. Prescribes disclaimer language required to be included on any material offering the sale of securities of a certified capital company.

## ***Premium Tax Credit Allocation & Certified Capital Companies***

39. Allows DOC to begin accepting premium tax credit allocation claims after January 1, 2005.

40. Requires a certified investor to mobilize a person to invest certified capital in the certified capital company in an amount that is equal to the premium tax allocated by the certified investor.

41. Requires the certified investor to prepare and execute a premium tax credit allocation claim form provided by DOC and submit the executed form to the certified capital company.

42. Requires the form to include an affidavit of the certified investor pursuant to which the investor is legally bound and irrevocably committed to invest certified capital in the certified capital company in the amount allocated, even if the allocated amount is less than the amount of the claim.

43. Requires a certified capital company to file all premium tax credit allocation claims with DOC.

44. Caps the total amount of certified capital for which premium tax credits are allowed for all certified investors to \$15 million in any fiscal year.

45. States the maximum amount of certified capital for which premium tax credits are allowed to any certified investor and all of its affiliates in one or more certified capital companies to \$15 million for any fiscal year.

46. Requires DOC to conduct an annual review of each certified capital company to determine whether the company is complying with the requirements of certification, to advise the company as to the eligibility of its qualified investments and to ensure that no investment has been made that violates the requirements of the VCA Program.

47. Requires the certified capital company to pay the cost of the annual review determined by DOC.

48. Requires DOC to allocate premium tax credits to certified investors in the order that the premium tax credit allocation claims are filed by the certified capital companies and states those received on the same day are considered to have been made simultaneously.

49. Requires DOC to use a pro rata allocation if two or more certified capital companies file premium tax credit allocation claims on the same day and the total of the claims exceeds \$15 million.

50. Requires DOC to notify the certified capital company of the amount of the tax credits allocated to each of its certified investors within five business days of receiving the allocation claim from the company.

51. Stipulates the portion of the premium tax credits allocated to a certified investor is forfeited if a certified capital company does not receive an investment of certified capital from a certified investor within five business days of receiving notice of the allocation and:

- a) Requires the certified capital company to notify DOC of the failure of the investment by certified mail.
- b) Requires DOC to reallocate the amount of capital that was certified to other certified investors in all certified capital companies on a pro rata basis.

52. Prescribes requirements and the following schedule for a certified capital company to maintain its certification:

- a) Within 18 months after its allocation date, a capital company must make qualified investments that total at least one-third of its certified capital.
- b) Within three years after its allocation date, a capital company must make qualified investments that total at least two-thirds of its certified capital.
- c) Within eight years after its allocation date, a capital company must make qualified investments equal to all of its certified capital.

## ***Premium Tax Credit***

53. Specifies a certified investor who receives an allocation of premium tax credits is entitled to a vested credit against the insurance premium tax equal to 100 percent of the investor's investment in certified capital in that calendar year.

54. States the first year the premium tax credit may be claimed is the third year after the investment and may not be more than ten percent of the amount of the vested credit against tax liability in any calendar year.

55. Prohibits the premium tax credit from being used against the portion of the insurance premium tax payable to the Fire Fighters' Relief and Pension Fund or to the Public Safety Personnel Retirement System .

56. Prohibits the applied premium tax credit from exceeding the certified investor's tax liability for that year and allows any unused amount to be carried forward to subsequent years' tax liability until it is exhausted.

57. Stipulates a certified investor claiming the premium tax credit is not required to pay any additional retaliatory tax levied as a result of claiming the credit.

58. Allows a certified investor to transfer or sell a premium tax credit and requires DOC to adopt rules to facilitate the transfer or sale of the credits.

59. Stipulates any premium tax credit recaptured is the liability of the taxpayer that actually claimed the credit.

60. Requires DOC, with the assistance of the Department of Insurance (DOI), to develop a registration and verification system for the tax credits.

## ***Certified Capital Company, Qualified Investments & Qualified Businesses***

61. Allows a certified capital company to request from DOC a written opinion that a business qualifies as a qualified business for the purpose of making a qualified investment.

62. Requires DOC to determine whether the business qualifies as a qualified business within ten working days of the request and to notify the certified capital company of its determination.

63. Considers the business in which the investment was proposed to be made in a qualified business if DOC fails to notify the certified capital company within the ten day period.

64. Allows DOC to consider a business a qualified business if DOC determines the business fails to meet all of the requirements but does determine the proposed investment will further state economic development.

65. Stipulates a qualified business retains its classification as a qualified business after the company is first invested in by a certified capital company and may receive subsequent investments from any certified capital company.
66. Requires a certified capital company to make at least one-half of its qualified investments in qualified businesses that are in pre-early or first stage of entrepreneurial development according to generally accepted standards of entrepreneurial financing.
67. Requires at least 25 percent of qualified investments be allocated to serve businesses and projects in rural areas of Arizona.
68. Requires at least 15 percent of qualified investments be allocated for investment in small business investment companies or small business companies in formation that are located in Arizona and have identified as their primary investment strategy investing in the formation of manufacturing enterprises on or near Indian reservations in Arizona.
69. Prohibits a qualified investment from being made at a cost to a certified capital company greater than 15 percent of the total certified capital of the certified capital company at the time of the investment.
70. Prescribes investment requirements for a capital company that has certified capital not currently invested in qualified investments.
71. Prohibits a certified capital company from investing more than five percent of its certified capital in any security or policy issued by an insurance company, an affiliate or an account maintained by an insurance company or an affiliate unless the insurance company or affiliate provides a guaranty, indemnity, bond, insurance policy or other payment undertaking in the favor of the certified investors.
72. Requires a certified capital company after the first six months of the company's initial certification date to pay a nonrefundable certification fee established by DOC by January 31 of each year.
73. Requires certified capital companies after receiving certified capital to report specified information about the certified investor and the premium tax credits to DOC.
74. Requires certified capital companies to report specified information regarding the amount of certified capital and the qualified investments being made to DOC by January 31, annually.
75. Requires certified capital companies to submit an annual audited financial statement that includes the opinion of an independent certified public account by September 30 of each year and stipulates the requirements of the audit.

## ***Distributions of Certified Capital***

76. Allows a certified capital company to make qualified distributions at any time.

77. Allows a certified capital company to make a distribution of certified capital to its equity holders, other than a qualified distribution, if the company has made qualified investments in an amount cumulatively equal to 100 percent of its certified capital.

78. Stipulates a qualified distribution is any distribution or payment from certified capital to equity holders of a certified capital company in connection with specified costs.

#### **Decertification**

79. Stipulates any material violation of the Program is cause for decertification of a certified capital company.

80. Requires DOC to notify a certified capital company in writing that the company may be subject to decertification if DOC finds that the company is not in compliance with the requirements of the Program within 120 days after the date of the notice.

81. Allows DOC to send notice of decertification to the certified capital company and to DOI if the violation remains uncorrected after the 120 day notice period.

## ***Recapture and Forfeiture***

82. Stipulates if a certified capital company has made qualified investments in at least one-third of its initial certified capital within 18 months after its allocation date, but fails to increase the qualified investments to two-thirds within three years after its allocation date:

- a) The premium tax credits that have been or will be taken by certified investors within 18 months after the allocation date are not subject to recapture or forfeiture.
- b) The premium tax credits that have been or will be taken by certified investors after 18 months after the allocation date are subject to recapture or forfeiture.

83. Stipulates if a certified capital company has made qualified investments of at least one-third of its initial certified capital within 18 months and then two-thirds within three years after its allocation date but fails to make qualified investments equal to all of its certified capital within eight years of its allocation date:

- a) The premium tax credits that have been or will be taken by certified investors within three years after the allocation date are not subject to recapture or forfeiture.
- b) The premium tax credits that have been or will be taken by certified investors after the third year after the allocation date are subject to recapture or forfeiture.

84. Stipulates the decertification of a certified capital company may cause the recapture of premium tax credits previously claimed and the forfeiture of future premium tax credits.

85. Requires all premium tax credits previously claimed by certified investors to be recaptured and all future premium tax credits to be claimed by certified investors to be forfeited if the certified capital company has been decertified within three years after its allocation date.

86. Requires all monies recaptured or forfeited be deposited in the state General Fund.

87. Requires DOC to send a written notice to each certified investor whose premium tax credit has been recaptured or forfeited.

88. Allows DOC to waive a recapture or forfeiture of a tax credit if it determines that a waiver will further state economic development.

### ***Miscellaneous***

89. Allows an audit to be conducted by an independent certified public accounting firm to be done on a certified capital company's cumulative distributions to equity holders that exceed the certified capital company's certified capital. Requires the audit to determine whether aggregate cumulative distributions to all investors and equity holders combined with all tax credits used resulted in an annual internal rate of return of 15 percent or more.

90. Requires 30 percent of any excess distributions determined by the audit to be paid by the certified capital company to DOC for deposit into the state General Fund.

91. Stipulates once a certified capital company has invested an amount cumulatively equal to 100 percent of its certified capital in qualified investments the company is no longer subject to regulation under the Program or DOC and all the premium tax credits are no longer subject to recapture or forfeiture.

92. Requires DOC to submit an annual report to the Governor and Legislature regarding the VCA Program and specifies the information that should be contained in the report.

93. Stipulates a certified investor is subject to the investment requirements of domestic insurers with respect to any amount of certified capital invested in a certified capital company.

94. Exempts DOC from the procurement code in soliciting investment proposals from investment groups or in selecting the designated investor group.

95. Allows DOR to disclose to DOC confidential information relating to income tax credits issued, transferred or used by the designated investor group.

96. Requires the Auditor General to conduct a performance audit of the Arizona Capital Investment Program and the VCA Program during FY 2012-2013 and to report its finding and recommendations to the Legislature by November 15, 2013.

97. Makes a blank appropriation from the state General Fund in FY 2004-2005 to DOC for the purpose of administering the Program.

98. Prescribes definitions.

99. Provides for a general effective date.

Prepared by Senate Staff  
March 2, 2004