

UTAH VENTURE CAPITAL ENHANCEMENT

ACT AMENDMENTS

2005 GENERAL SESSION

STATE OF UTAH

Sponsor: Peggy Wallace

LONG TITLE

General Description:

This bill modifies provisions of the Utah Venture Capital Enhancement Act.

Highlighted Provisions:

This bill:

- ▶ modifies the purpose provision of the act by emphasizing the protection of state interests by limiting the manner in which contingent tax credits are issued, registered, transferred, claimed as an offset, and redeemed;
- ▶ provides that a contingent tax credit shall be claimed as a refundable credit;
- ▶ provides that the State Tax Commission develop a system that will verify the validity of any claimed contingent tax credit under the act; and
- ▶ exempts the Utah Capital Investment Corporation and its board of directors from the requirement to report fund performance of venture firms and private equity firms.

Monies Appropriated in this Bill:

None

Other Special Clauses:

This bill provides an immediate effective date.

Utah Code Sections Affected:

AMENDS:

9-2-1902, as last amended by Chapter 4, Laws of Utah 2003, Second Special Session

9-2-1915, as enacted by Chapter 291, Laws of Utah 2003

9-2-1918, as enacted by Chapter 291, Laws of Utah 2003

9-2-1919, as enacted by Chapter 291, Laws of Utah 2003

9-2-1920, as enacted by Chapter 291, Laws of Utah 2003

9-2-1924, as enacted by Chapter 291, Laws of Utah 2003

Be it enacted by the Legislature of the state of Utah:

Section 1. Section **9-2-1902** is amended to read:

9-2-1902. Findings -- Purpose.

(1) The Legislature finds that:

(a) fundamental changes have occurred in national and international financial markets and in the state's financial markets;

(b) a critical shortage of seed and venture capital resources exists in the state, and that shortage is impairing the growth of commerce in the state;

(c) a need exists to increase the availability of venture equity capital for emerging, expanding, and restructuring enterprises in Utah, including enterprises in the life sciences, advanced manufacturing, and information technology;

(d) increased venture equity capital investments in emerging, expanding, and restructuring enterprises in Utah will:

(i) create new jobs in the state; and

(ii) help to diversify the state's economic base; and

(e) a well-trained work force is critical for the maintenance and development of Utah's economy.

(2) This part is enacted to:

(a) mobilize private investment in a broad variety of venture capital partnerships in diversified industries and locales;

(b) retain the private-sector culture of focusing on rate of return in the investing process;

(c) secure the services of the best managers in the venture capital industry, regardless of location;

(d) facilitate the organization of the Utah fund of funds to seek private investments and

to serve as a catalyst in those investments by offering state incentives for private persons to make investments in the Utah fund of funds;

(e) enhance the venture capital culture and infrastructure in the state so as to increase venture capital investment within the state and to promote venture capital investing within the state; [~~and~~]

(f) accomplish the purposes referred to in Subsections (2)(a) through (e) in a manner that would maximize the direct economic impact for the state[-]; and

(g) authorize the issuance and use of contingent tax credits to accomplish the purposes referred to in Subsections (2)(a) through (e) while protecting the interests of the state by limiting the manner in which contingent tax credits are issued, registered, transferred, claimed as an offset to the payment of state income tax, and redeemed.

Section 2. Section **9-2-1915** is amended to read:

9-2-1915. Investments by Utah fund of funds.

(1) The Utah fund of funds shall invest funds:

(a) principally in high-quality venture capital funds managed by investment managers who have:

- (i) made a commitment to equity investments in businesses located within the state; and
- (ii) have committed to maintain a physical presence within the state;

(b) in private venture capital funds and not in direct investments in individual businesses; and

(c) in venture capital funds with experienced managers or management teams with demonstrated expertise and a successful history in the investment of venture capital funds.

(2) (a) The Utah fund of funds shall give priority to investments in private seed and venture capital partnerships and entities that have demonstrated a commitment to the state as evidenced by:

- (i) the investments they have made in Utah-based entities;
- (ii) the correspondent relationships they have established with Utah-based venture capital funds; or

(iii) the commitment they have made to expand the reach of expertise within the state by adding additional investment areas of expertise.

(b) The manager of the Utah fund of funds may waive the priorities under Subsection (2)(a) only if necessary to achieve the targeted investment returns required to attract designated investors.

(3) The Utah fund of funds may invest funds in a newly created venture capital fund only if the managers or management team of the fund have the experience, expertise, and a successful history in the investment of venture capital funds as described in Subsection (1)(c).

(4) (a) An investment or investments by the Utah fund of funds in any venture capital fund may comprise no more than 20% of the total committed capital in the venture capital fund.

(b) (i) No more than 50% of the funds invested by the Utah fund of funds may be made with venture capital entities with offices in the state established prior to July 1, 2002.

(ii) The restriction under Subsection (4)(b)(i) shall remain in place until three additional venture capital entities open new offices in the state.

Section 3. Section **9-2-1918** is amended to read:

9-2-1918. Certificates and contingent tax credits.

(1) In accordance with Title 63, Chapter 46a, Utah Administrative Rulemaking Act, the board, in consultation with the State Tax Commission, shall make rules governing the form, issuance, transfer, and redemption of certificates.

(2) The board's issuance of certificates and related contingent tax credits to designated investors shall be subject to the following:

(a) the aggregate outstanding certificates may not exceed a total of \$100,000,000 of contingent tax credits;

(b) the certificates shall be issued contemporaneously with an investment in the Utah fund of funds by a designated investor;

(c) contingent tax credits shall be issued in a manner that not more than \$20,000,000 of contingent tax credits may be initially redeemable in any fiscal year; and

(d) the credits are certifiable if there are insufficient funds in the redemption reserve to

make a cash redemption and the board does not exercise its other options under Subsection 9-2-1920(3)(b).

(3) In determining the \$100,000,000 maximum limit in Subsection (2)(a) and the \$20,000,000 limitation in Subsection (2)(c):

(a) the board shall use the cumulative amount of scheduled aggregate returns on certificates issued by the board to designated investors;

(b) certificates and related contingent tax credits which have expired may not be included; and

(c) certificates and related contingent tax credits which have been redeemed shall be included only to the extent of tax credits actually allowed.

(4) Contingent tax credits are subject to the following:

(a) a contingent tax credit may not be redeemed except by a designated investor in accordance with the terms of a certificate from the board;

(b) a contingent tax credit may not be redeemed prior to the time the Utah fund of funds receives full payment from the designated investor for the certificate;

(c) a contingent tax credit shall be claimed for a tax year that begins during the calendar year maturity date stated on the certificate;

(d) an investor who redeems a certificate and the related contingent tax credit shall allocate the amount of the contingent tax credit to the taxpayers of the investor based on the taxpayer's pro rata share of the investor's earnings; and

~~[(e) any contingent tax credit in excess of the taxpayer's tax liability for the tax year may be credited to the tax liability until the earlier of:]~~

~~[(i) the depletion of the contingent tax credit; or]~~

~~[(ii) a period not to exceed seven years.]~~

(e) a contingent tax credit shall be claimed as a refundable credit.

(5) In calculating the amount of a contingent tax credit:

(a) a contingent tax credit shall be certified by the board only if the actual return to the designated investor is less than the return that was targeted at the issuance of the certificate;

- (b) the amount of the contingent tax credit may not exceed the difference between:
 - (i) the sum of:
 - (A) the initial equity investment of the designated investor in the Utah fund of funds; and
 - (B) the scheduled aggregate return to the designated investor at rates of return authorized by the board at the issuance of the certificate; and
 - (ii) the aggregate actual return received by the designated investor and any predecessor in interest of the initial equity investment and interest on the initial equity investment; and
- (c) the rates, whether fixed rates or variable rates, shall be determined by a formula stipulated in the certificate.
- (6) The board shall clearly indicate on the certificate:
 - (a) the targeted return on the invested capital;
 - (b) the amount of the initial equity investment;
 - (c) the calculation formula for determining the scheduled aggregate return on the initial equity investment; and
 - (d) the calculation formula for determining the amount of the contingent tax credit that may be claimed.
- (7) Once moneys are invested by a designated investor, the certificate:
 - (a) shall be binding on the board; and
 - (b) may not be modified, terminated, or rescinded.
- (8) Funds invested by a designated investor for a certificate shall be paid to the corporation for placement in the Utah fund of funds.
- (9) The State Tax Commission may, in accordance with Title 63, Chapter 46a, Utah Administrative Rulemaking Act, and in consultation with the board, make rules to help implement this section.

Section 4. Section **9-2-1919** is amended to read:

9-2-1919. Transfer and registration of certificates.

- (1) A certificate and the related contingent tax credit may be transferred by the designated investor.

(2) The board, in conjunction with the State Tax Commission, shall develop:

(a) a system for registration of any certificate and related contingent tax credit issued or transferred under this part; and

(b) a system that permits verification that:

(i) any contingent tax credit claimed [~~upon a tax return~~] is valid; and

(ii) any transfers of the certificate and related contingent tax credit are made in accordance with the requirements of this part.

(3) A certificate or contingent tax credit issued or transferred under this part may not be considered a security under Title 61, Chapter 1, Utah Uniform Securities Act.

Section 5. Section **9-2-1920** is amended to read:

9-2-1920. Redemption of certificates.

(1) If a designated investor elects to redeem a certificate, the certificate shall be presented to the board for redemption no later than June 30 of the calendar year maturity date stated on the certificate.

(2) Upon presentment to the board, it shall determine and certify the amount of the contingent tax credit that may be claimed by the designated investor based on:

(a) the limitations in Section 9-2-1918; and

(b) rules made by the board in accordance with Title 63, Chapter 46a, Utah Administrative Rulemaking Act.

(3) (a) If there are sufficient funds in the redemption reserve, the board shall direct the corporation to make a cash redemption of the certificate.

(b) If there are insufficient funds in the redemption reserve, the board may elect to redeem the certificate:

(i) by certifying a contingent tax credit to the designated investor; or

(ii) by making demand on designated purchasers to purchase certificates in accordance with Section 9-2-1921.

(4) The board shall certify to the State Tax Commission the contingent tax credit which can be claimed by the designated investor with respect to the redemption of the certificate.

(5) The board shall cancel all redeemed certificates.

Section 6. Section **9-2-1924** is amended to read:

9-2-1924. Exemption from certain statutes.

(1) Except as otherwise provided in this part, the corporation is exempt from statutes governing state agencies, as provided in Section 63E-2-109.

(2) The corporation shall be subject to:

(a) Title 52, Chapter 4, Open and Public Meetings [~~Act~~]; and

(b) except as provided in Subsection (3), Title 63, Chapter 2, Government Records Access and Management Act.

(3) The corporation and the board are exempt from the requirement to report fund performance of venture firms and private equity firms set forth in Title 63, Chapter 2, Government Records Access and Management Act.

Section 7. **Effective date.**

If approved by two-thirds of all the members elected to each house, this bill takes effect upon approval by the governor, or the day following the constitutional time limit of Utah Constitution Article VII, Section 8, without the governor's signature, or in the case of a veto, the date of veto override.