

- SUBJECT:** Certified capital company investments and related premium tax credits
- COMMITTEE:** Insurance — committee substitute recommended
- VOTE:** 5 ayes — Smithee, G. Lewis, J. Moreno, Olivo, Thompson
0 nays
4 absent — Eiland, Averitt, Burnam, Seaman
- SENATE VOTE:** On final passage, April 4 — 25-3-2 (Ogden, Shapleigh, Truan voting nay; Ellis present, not voting)
- WITNESSES:** For — Thomas Adamek, Stonehenge Capital Corp.; Dave Dooley; Phil Thomas, Growth Capital Alliance
Against — Jay Thompson, Prudential Insurance Co.
- BACKGROUND:** Five states — Louisiana, Missouri, New York, Wisconsin, and Florida — have adopted laws authorizing the creation of certified capital company (CAPCO) programs. CAPCOs are venture capital funds registered with the state that invest solely in certain small businesses and startup operations. By investing in CAPCOs, insurance companies receive tax credits against their premium tax liabilities. CAPCO managers make investment decisions on behalf of investors; the state does not direct investment activity. CAPCOs are subject to state oversight. They must comply with an annual audit and must file financial statements and reports periodically.
- DIGEST:** CSSB 601 would require the comptroller to establish application procedures for CAPCOs and would allow the comptroller to adopt rules and forms as necessary for implementation. The bill would establish qualifications and application procedures for a CAPCO. It would prohibit an insurance company, group of insurance companies, or other people who could have state premium tax liability, or their affiliates, from managing, having certain ownership of, or controlling the direction of investments for a CAPCO.
- The bill would specify provisions related to:

- ! offering material used by a CAPCO;
- ! requirements for a certification continuance;
- ! evaluation of a business by the comptroller for CAPCO investment purposes;
- ! annual report of a CAPCO to the comptroller and CAPCO annual audited financial statements;
- ! renewal fee for a CAPCO;
- ! CAPCO distributions and repayment of debts by companies;
- ! annual review of a CAPCO by the comptroller; and
- ! decertification of a CAPCO and recapture and forfeiture of a premium tax credit.

CSSB 601 would allow the comptroller to impose an administrative penalty on a CAPCO that violated the bill's provisions in an amount not to exceed \$25,000 for each day a violation continued. Each day a violation continued or occurred would be a separate violation for the purpose of imposing a penalty. The bill would specify criteria for the basis of a penalty. The attorney general could sue to collect the penalty. A CAPCO could agree to indemnify against or buy insurance for losses resulting from recapture or forfeiture of premium tax credits.

A certified investor, such as an insurance company, that made an investment in a CAPCO would earn, in the year of the investment, a vested credit against state premium tax liability equal to 100 percent of the investment of certified capital, subject to certain limits. A certified investor could take up to 10 percent of the vested premium tax credit in any taxable year of the certified investor.

The total amount of certified capital for which premium tax credits could be permitted for all years would be \$200 million. The aggregate amount of certified capital for which premium tax credits could be allowed in a year for all certified investors could not exceed total credits of \$20 million. The maximum amount of certified capital for which premium tax credit could be allowed on behalf of any one certified investor and its affiliates, whether by one or more CAPCOs, could not exceed the greater of \$10 million or 15 percent of the maximum aggregate amount available under the above provision. If the total premium tax credits claimed by all investors exceeded the total limits on premium tax credits allowed by the bill, the comptroller

would have to allocate the total amount of premium tax credits to certified investors in CAPCOs on a pro-rata basis.

A certified investor would not have to reduce the amount of premium tax included by the investor in connection with ratemaking for any insurance contract written in Texas because of a reduction in the investor's premium tax derived from credit granted under the bill. The comptroller would have to adopt rules to facilitate the transfer or assignment of premium tax credits by certified investors.

The Texas Department of Economic Development would have to promote the CAPCO program through its Texas Business and Community Economic Development Clearinghouse.

The comptroller would have to prepare a biennial report with respect to the implementation of this program and would have to file the report with the governor, lieutenant governor, and House speaker not later than December 15 of each even-numbered year.

The comptroller could implement this program only if the comptroller determined, on the basis of a revenue estimate made after adjournment of the regular session of the 77th Legislature, that revenues were anticipated in amounts sufficient to finance all appropriations made during the session, after deducting all reductions in taxes, including the reduction in premium taxes through the proposed credits. The bill would provide for a situation in which the comptroller determined that anticipated revenues would support a part, but not all, of the authorized premium tax credits. The comptroller would have to notify the governor, lieutenant governor, and House speaker of the determination with regard to sufficient funds.

This bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2001. The comptroller would have to implement the bill's provisions within 60 days after the bill took effect. A certified investor could not make an investment with a CAPCO before February 15, 2002.

SUPPORTERS
SAY:

CSSB 601 would create an option for the state to provide funding through tax credits to entrepreneurs so they could start and operate businesses in Texas.

The bill would create a CAPCO program by providing insurance companies an investment credit against their state premium tax liability, limited to \$200 million over the life of the program. These state-authorized, privately owned and operated venture capital funds would target investments in small and startup businesses in Texas. The state ultimately would benefit from new jobs and additional state and local taxes.

Under CSSB 601, the comptroller would establish rules to administer this program and certify qualified CAPCOs. CAPCOs then would obtain capital from investor insurance companies. Corresponding with insurer investments, the comptroller would allocate available tax credits on a pro-rata basis. Once the tax credits were allocated, CAPCOs would have to meet investment thresholds by placing startup capital in Texas businesses. No CAPCO could take a profit distribution from a business until it had invested 100 percent of its capital. No tax credits could be authorized unless the comptroller determined that there were sufficient revenues to support the CAPCO program. One compelling reason to support this bill is the program's track record of success in other states.

OPPONENTS
SAY:

CSSB 601 raises the concern of whether the state should encourage any private business to invest in the bonds and securities of other private businesses. The state should examine closely whether to authorize a program that would create an incentive to put money into a high-risk financial vehicle for the benefit of insurance companies and at the expense of the state. The success of CAPCO programs in other states has been exaggerated, and Louisiana has reported problems with its program.

CSHB 601 would promote the interests of large, national CAPCO firms more than it would stimulate small Texas businesses. Instead of creating a CAPCO program that primarily would benefit insurers, the state should invest more of its money in local venture capital funds, which would be more responsive to small local businesses and startup companies. For example, the state could establish venture capital funds to invest in its university systems to study and develop biotechnology, or it could invest in municipalities to attract more high-tech businesses, rather than simply forfeit tax revenues to insurance companies.

NOTES:

The bill's fiscal note estimates that the state would lose about \$5.1 million in premium taxes per year because of the CAPCO program. This analysis presumes that 25 percent of the maximum possible credits would be taken and granted in any one year.

The House Insurance Committee considered SB 601 in lieu of the House companion bill, HB 3177 by Solis. The committee substitute differs from the original bill by modifying the definition of a "qualified business." The substitute removed a provision that would have authorized not more than one affiliate of the certified investors in any CAPCO to provide a guaranty, indemnity, bond, insurance policy, or other payment undertaking in favor of all of the certified investors of the CAPCO and its affiliates.

A nearly identical bill in the 76th Legislature, SB 899 by Sibley, passed the Senate and was amended on the House floor before passing on the Local, Consent, and Resolutions Calendar. The Senate failed to take action on the House amendment.