

## **BILL ANALYSIS**

Senate Research Center  
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By: Carona  
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### **DIGEST AND PURPOSE**

Currently, Texas does not offer insurance companies a premium tax credit for investing in small business venture capital funds. As proposed, S.B. 601 creates certified capital companies funded by insurance companies that may in turn invest in small, early-stage businesses. In exchange for their investment, insurance companies receive certain premium tax credits.

### **RULEMAKING AUTHORITY**

Rulemaking authority is expressly granted to the comptroller of public accounts in SECTIONS 1 and 3 (Articles 4.52, 4.53, 4.64, 4.72, and 4.75, Insurance Code) of this bill.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Chapter 4, Insurance Code, by adding Subchapter B, as follows:

#### **SUBCHAPTER B. PREMIUM TAX CREDIT FOR INVESTMENT IN CERTIFIED CAPITAL COMPANY**

Art. 4.51. DEFINITIONS. Defines “affiliate,” “certification date,” “certified capital,” “certified capital company,” “certified investor,” “early stage business,” “person,” “premium tax credit allocation claim,” “qualified business,” “qualified debt instrument,” “qualified distribution,” “qualified investment,” and “state premium tax liability.”

Art. 4.52. DUTIES OF COMPTROLLER; RULES. Requires the comptroller to administer this subchapter and adopt rules and forms as necessary to implement this subchapter.

Art. 4.53. CERTIFICATION. (a) Requires the comptroller by rule to establish the application procedures for certified capital companies.

(b) Requires an applicant to file an application not later than April 17, 2002, in the form prescribed by the comptroller accompanied by a nonrefundable application fee of \$7,500. Requires the application to include an audited balance sheet of the applicant, with an unqualified opinion from an independent certified public accountant, as of a date not more than 35 days before the date of the application.

(c) Provides that certain requirements must be met to qualify as a certified capital company.

(d) Requires the comptroller to review the application, organizational documents, and business history of each applicant and to ensure that the applicant satisfies the requirements of this subchapter.

(e) Requires the comptroller, not later than the 30th day after the date an application is

filed, to issue the certification or refuse to issue the certification and communicate in detail to the applicant the grounds for the refusal, including suggestions for the removal of those grounds.

Art. 4.54. MANAGEMENT BY CERTAIN ENTITIES PROHIBITED. (a) Provides that an insurance company, group of insurance companies, or other persons who may have state premium tax liability or the affiliates of the insurance companies or other persons may not, directly or indirectly, manage a certified capital company; beneficially own, whether through rights, options, convertible interests, or otherwise, more than 10 percent of the outstanding voting securities of a certified capital company; or control the direction of investments for a certified capital company.

(b) Provides that Subsection (a) of this article applies without regard to whether the insurance company or other person or the affiliate of the insurance company or other person is licensed by or transacts business in this state.

(c) Provides that this article does not preclude a certified investor, insurance company, or any other party from exercising its legal rights and remedies, including interim management of a certified capital company, if authorized by law, with respect to a certified capital company that is in default of its statutory or contractual obligations to the certified investor, insurance company, or other party.

Art. 4.55. OFFERING MATERIAL USED BY CERTIFIED CAPITAL COMPANY. Requires any offering material involving the sale of securities of the certified capital company to include a certain statement.

Art. 4.56. REQUIREMENTS FOR CONTINUANCE OF CERTIFICATION.

(a) Requires a certified capital company, to continue to be certified, to make qualified investments according to a certain schedule.

(b) Requires at least 50 percent of the amount of qualified investments required by Subsections (a)(1) and (2) of this article to be placed in early stage businesses.

(c) Requires the aggregate cumulative amount of all qualified investments made by the certified capital company after its certification date to be considered in the computation of the percentage requirements under this subchapter. Authorizes any proceeds received from a qualified investment to be invested in another qualified investment and count toward any requirement in this subchapter with respect to investments of certified capital.

(d) Provides that a business that is classified as a qualified business at the time of the first investment in the business by a certified capital company remains classified as a qualified business and can receive follow-on investments from any certified capital company. Provides that except as provided by this subsection, a follow-on investment made under this subsection is a qualified investment even though the business may not meet the definition of a qualified business at the time of the follow-on investment. Provides that a follow-on investment does not qualify as a qualified investment if, at the time of the follow-on investment, the qualified business no longer has its principal business operations in this state.

(e) 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 company at the time of investment.

(f) Provides that if, before the 90th day after the date that a certified capital company

makes an investment in a qualified business, the qualified business moves its principal business operations from this state, the investment may not be considered a qualified investment for purposes of the percentage requirements under this subchapter.

(g) Requires a certified capital company to invest any certified capital not invested in qualified investments in certain investments.

Art. 4.57. EVALUATION OF BUSINESS BY COMPTROLLER. (a) Authorizes a certified capital company, before making an investment in a business, to request from the comptroller a written opinion as to whether the business in which it proposes to invest is a qualified business or an early stage business.

(b) Requires the comptroller to determine, not later than the 15th business day after the date of the receipt of a request under Subsection (a) of this article, whether the business meets the definition of a qualified business or an early stage business, as applicable, and notify the certified capital company of the determination and an explanation of its determination or notify the certified capital company that an additional 15 days will be needed to review and make the determination.

(c) Provides that if the comptroller fails to notify the certified capital company with respect to the proposed investment within the period specified by Subsection (b) of this article, the business in which the company proposes to invest is considered to be a qualified business or early stage business, as appropriate.

Art. 4.58. REPORTS TO COMPTROLLER; AUDITED FINANCIAL STATEMENT.

(a) Requires that each certified capital company report to the comptroller as soon as practicable after the receipt of certified capital certain requirements.

(b) Requires that, not later than January 31 of each year, each certified capital company report to the comptroller certain investment information.

(c) Requires that, not later than April 1 of each year, the company provide to the comptroller an annual audited financial statement that includes the opinion of an independent certified public accountant. Requires the audit to address the methods of operation and conduct of the business of the company to determine whether certain conditions are met.

Art. 4.59. RENEWAL. (a) Requires each certified capital company, not later than January 31 of each year, to pay a nonrefundable renewal fee of \$5,000 to the comptroller.

(b) Provides that notwithstanding Subsection (a) of this article, a renewal fee is not required within six months of the initial certification date of a certified capital company.

Art. 4.60. DISTRIBUTIONS; REPAYMENT OF DEBT. (a) Authorizes a certified capital company to make a qualified distribution at any time. Requires the company, to make a distribution or payment, other than a qualified distribution, to have made qualified investments in an amount cumulatively equal to 100 percent of its certified capital.

(b) Provides that notwithstanding Subsection (a) of this article, a company may make repayments of principal and interest on its indebtedness without any restriction, including repayments of indebtedness of the company on which certified investors earned premium tax credits.

Art. 4.61. ANNUAL REVIEW; DECERTIFICATION. (a) Requires the comptroller to

conduct an annual review of each certified capital company to determine certain factors.

(b) Requires the cost of the annual review to be paid by each certified capital company according to a reasonable fee schedule adopted by the comptroller.

(c) Provides that a material violation of Article 4.56, 4.58, or 4.59 of this code is grounds for decertification of the certified capital company. Requires the comptroller, if the comptroller determines that a company is not in compliance with Article 4.56, 4.58, or 4.59 of this code, to notify the officers of the company in writing that the company may be subject to decertification after the 120th day after the date of mailing of the notice, unless the deficiencies are corrected and the company returns to compliance with those articles.

(d) Authorizes the comptroller to decertify a certified capital company, after opportunity for hearing, if the comptroller finds that the company is not in compliance with Article 4.56, 4.58, or 4.59 of this code at the end of the period established by Subsection (c) of this article. Provides that decertification under this subsection is effective on receipt of notice of decertification by the company. Requires the comptroller to notify any appropriate state agency of the decertification.

Art. 4.62. ADMINISTRATIVE PENALTY. (a) Authorizes the comptroller to impose an administrative penalty on a certified capital company that violates this subchapter.

(b) Prohibits the amount of the penalty from exceeding \$25,000 and provides that each day a violation continues or occurs is a separate violation for the purpose of imposing a penalty. Requires the amount of the penalty to be based on certain factors.

(c) Authorizes a certified capital company assessed a penalty under this subchapter to request a redetermination as provided in Chapter 111, Tax Code.

(d) Authorizes the attorney general to sue to collect the penalty.

(e) Provides that a proceeding to impose the penalty is considered to be a contested case under Chapter 2001(Administrative Procedure), Government Code.

Art. 4.63. RECAPTURE AND FORFEITURE OF PREMIUM TAX CREDITS: DECERTIFICATION OF COMPANY. (a) Provides that decertification of a certified capital company may cause by certain methods the recapture of premium tax credits previously claimed and the forfeiture of future premium tax credits to be claimed by certified investors with respect to the company.

(b) Requires the comptroller to send written notice to the address of each certified investor whose premium tax credit is subject to recapture or forfeiture, using the address shown on the last premium tax filing.

Art. 4.64. RECAPTURE AND FORFEITURE OF PREMIUM TAX CREDITS: QUALIFIED BUSINESS LEAVES STATE. (a) Requires the comptroller to adopt rules under which premium tax credits previously claimed by certified investors are subject to recapture and future premium tax credits to be claimed by certified investors are subject to forfeiture with respect to an investment made by a certified capital company in a qualified business if the qualified business fails to maintain its principal business operations in this state as required by the rules.

(b) Requires the rules adopted by the comptroller to specify the manner in which the recapture and forfeiture of premium tax credits under this article may be apportioned

among certified investors in a certified capital company.

(c) Requires the comptroller to send written notice to the address of each certified investor whose premium tax credit is subject to recapture or forfeiture, using the address shown on the last premium tax filing.

Art. 4.65. INDEMNITY AGREEMENTS AND INSURANCE AUTHORIZED. Authorizes a certified capital company to agree to indemnify, or purchase insurance for the benefit of, a certified investor for losses resulting from the recapture or forfeiture of premium tax credits under Article 4.63 or 4.64 of this code.

Art. 4.66. PREMIUM TAX CREDIT. (a) Requires a certified investor who makes an investment of certified capital to, in the year of investment, earn a vested credit against state premium tax liability equal to 100 percent of the certified investor's investment of certified capital, subject to the limits imposed by this subchapter. Authorizes a certified investor to take up to 10 percent of the vested premium tax credit in any taxable year of the certified investor.

(b) Prohibits the credit to be applied against state premium tax liability in any one year from exceeding the state premium tax liability of the certified investor for the taxable year. Authorizes any unused credit against state premium tax liability to be carried forward indefinitely until the premium tax credits are used.

(c) Provides that a certified investor claiming a credit against state premium tax liability earned through an investment in a company is not required to pay any additional retaliatory tax levied under Article 21.46 of this code as a result of claiming that credit. Provides that an investment made under this subchapter is a "Texas investment" for purposes of Subchapter A of this chapter.

Art. 4.67. PREMIUM TAX CREDIT ALLOCATION CLAIM FORM. (a) Requires a premium tax credit allocation claim to be prepared and executed by a certified investor on a form provided by the comptroller. Requires the certified capital company to file the claim with the comptroller not later than August 17, 2002. Requires the premium tax credit allocation claim form to include an affidavit of the certified investor under which the certified investor becomes legally bound and irrevocably committed to make an investment of certified capital in a certified capital company in the amount allocated even if the amount allocated is less than the amount of the claim, subject only to the receipt of an allocation under Article 4.69 of this code.

(b) Prohibits a certified investor from claiming a premium tax credit under Article 4.66 of this code for an investment that has not been funded, even if the certified investor has committed to fund the investment.

Art. 4.68. TOTAL LIMIT ON CREDITS. (a) Provides that the total amount of certified capital for which premium tax credits may be allowed under this subchapter for all years in which premium tax credits are allowed is \$200 million.

(b) Prohibits the total amount of certified capital for which premium tax credits may be allowed for all certified investors under this subchapter from exceeding the amount that would entitle all certified investors in certified capital companies to take total credits of \$20 million in a year.

(c) Prohibits a certified capital company and its affiliates from filing premium tax credit allocation claims in excess of the maximum amount of certified capital for which premium tax credits are allowed as provided in this article.

Art. 4.69. PRO RATA ALLOCATION OF CREDITS. (a) Provides that this article applies

only if the total premium tax credits claimed by all certified investors exceeds the total limits on premium tax credits established by Article 4.68(a) of this code.

(b) Requires the comptroller to allocate the total amount of premium tax credits allowed under this subchapter to certified investors in certified capital companies on a pro rata basis in accordance with this article.

(c) Requires the pro rata allocation for each certified investor to be the product of certain amounts.

(d) Provides that the comptroller may take certain actions if, as a result of the pro rata allocation of premium tax credits under Subsection (c) of this article, certified investors in any certified capital company that submitted premium tax credit allocation claims would not be allocated at least \$7.5 million in premium tax credits for all years for which credits are allowed.

(e) Requires the comptroller, not later than September 15, 2002, to notify each certified capital company of the amount of tax credits allocated to each certified investor. Requires each certified capital company to notify each certified investor of their premium tax credit allocation.

(f) Requires a certified capital company if it does, not receive an investment of certified capital equaling the amount of premium tax credits allocated to a certified investor for which it filed a premium tax credit allocation claim before the end of the 10th business day after the date of receipt of notice of allocation, to notify the comptroller by overnight common carrier delivery service and requires that portion of capital allocated to the certified investor to be forfeited. Requires the comptroller reallocate the forfeited capital among the certified investors in the other certified capital companies that originally received an allocation so that the result after reallocation is the same as if the initial allocation under this article had been performed without considering the premium tax credit allocation claims that were subsequently forfeited.

(g) Prohibits the maximum amount of certified capital for which a premium tax credit allocation may be allowed on behalf of any one certified investor and its affiliates, whether by one or more certified capital companies, from exceeding \$2 million a year.

Art. 4.70. TREATMENT OF CREDITS AND CAPITAL. Authorizes, in any case under this code or another insurance law of this state in which the assets of a certified investor are examined or considered, the certified capital to be treated as an admitted asset, subject to the applicable statutory valuation procedures.

Art 4.71. IMPACT OF TAX CREDITS CLAIMED BY A CERTIFIED INVESTOR ON INSURANCE RATES. Provides that a certified investor is not required to reduce the amount of premium tax included by the investor in connection with ratemaking for any insurance contract written in this state because of a reduction in the investor's Texas premium tax derived from the credit granted under this subchapter.

Art. 4.72. TRANSFERABILITY OF CREDIT. (a) Authorizes a certified investor to transfer or assign premium tax credits to certain persons or entities.

(b) Requires the comptroller to adopt rules to facilitate the transfer or assignment of premium tax credits. Authorizes a certified investor to transfer or assign premium tax credits only in compliance with the rules adopted under this subsection.

(c) Provides that the transfer or assignment of a premium tax credit does not affect the

schedule for taking the premium tax credit under this subchapter.

Art. 4.73. PROMOTION. Requires the Texas Department of Economic Development to promote the program established under this subchapter in the Texas Business and Community Economic Development Clearinghouse.

Art. 4.74. REPORT TO LEGISLATURE. (a) Requires the comptroller to prepare a biennial report with respect to results of the implementation of this subchapter. Requires the report to include certain items.

(b) Requires the comptroller to file the report with the governor, the lieutenant governor, and the speaker of the house of representatives not later than December 15 of each even-numbered year.

Art. 4.75. IMPLEMENTATION SUBJECT TO AVAILABLE REVENUE. (a) Authorizes the comptroller, notwithstanding any other provision of this subchapter, to implement this subchapter only if the comptroller determines, on the basis of a revenue estimate made after the adjournment sine die of the regular session of the 77th Legislature, that revenues are anticipated in amounts sufficient to finance all appropriations made during the regular session of the 77th Legislature, after making deductions for all reductions in taxes, including the reduction in premium tax through premium tax credits authorized under this subchapter.

(b) Requires, the comptroller, if the comptroller determines under Subsection (a) of this article that revenues are anticipated to support a part, but less than all, of the premium tax credits authorized under Article 4.68 of this code, to reduce the total amount of premium tax credits allowed under that article in the amount necessary to comply with Subsection (a) of this article and adopt rules as necessary to implement this subchapter after the reduction made under Subdivision (1) of this subsection.

(c) Provides that rules adopted under Subsection (b)(2) of this article may adjust any deadline or other date established by this subchapter as necessary to implement this subchapter as limited by this article.

(d) Requires the comptroller to notify the governor, lieutenant governor, and speaker of the house of representatives of the determination made under Subsection (a) of this article.

SECTION 2. Provides that Articles 4.01 through 4.08, 4.10, 4.11, 4.11A, 4.11B, 4.11C, 4.12, and 4.17, 4.18, and 4.19, Insurance Code, are redesignated as Subchapter A, Chapter 4, Insurance Code, and a subchapter heading is added to read as follows:

#### SUBCHAPTER A. IMPOSITION AND COLLECTION OF TAXES AND FEES

SECTION 3. (a) Requires the comptroller, subject to Article 4.75, Insurance Code, as added by this Act, not later than the 60th day after the effective date of this Act, to adopt rules necessary to implement Chapter 4B, Insurance Code, as added by this Act. Requires the comptroller to begin accepting applications for certification as a certified capital company under that subchapter on the 90th day after the effective date of this Act.

(b) Prohibits a certified investor from making an investment with a certified capital company under Chapter 4B, Insurance Code, as added by this Act, before September 1, 2002.

SECTION 4. Effective date: upon passage or September 1, 2001.