

# HOUSE BILL REPORT

## HB 1923

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**As Reported by House Committee On:**  
Financial Institutions & Insurance

**Title:** An act relating to the creation of certified capital companies to promote investment in start-up and emerging Washington businesses.

**Brief Description:** Authorizing the creation of certified capital companies to promote investment in start-up and emerging Washington businesses.

**Sponsors:** Representatives P. Sullivan, Haler, Pettigrew, Walsh, Morrell, Strow, Kilmer, Kessler and Simpson.

**Brief History:**

**Committee Activity:**

Financial Institutions & Insurance: 2/24/05, 3/1/05 [DPS].

**Brief Summary of Substitute Bill**

- Provides for the creation of capital companies to promote investment in small businesses.
- Allows tax credits to insurance companies for qualified investments in certified capital companies.

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### HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 10 members: Representatives Kirby, Chair; Ericks, Vice Chair; Roach, Ranking Minority Member; Newhouse, Santos, Schual-Berke, Serben, Simpson, Strow and Williams.

**Minority Report:** Do not pass. Signed by 1 member: Representative Tom, Assistant Ranking Minority Member.

**Staff:** Cece Clynch (786-7168).

**Background:**

Some states, including Louisiana, New York, and Missouri, as well as the District of Columbia, have authorized the creation of certified capital companies (CAPCOs) which provide venture capital to small businesses in those states. The CAPCOs make direct financial investments into small businesses and work with entrepreneurs to grow these

businesses. Additional capital may be attracted to these small businesses because of the CAPCOs' initial investments, thus leveraging the original dollars.

Investments in CAPCOs are made attractive to insurance companies by allowing insurance companies investing in CAPCOs to take a premium tax write-off, spread out over time, for qualified investments. In Washington, all insurers except title insurers pay to the state treasurer, through the insurance commissioner, a 2 percent tax on premiums.

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### **Summary of Substitute Bill:**

A new chapter is created in Title 43 pertaining to CAPCO investments. A certified capital company or CAPCO is defined as:

- a partnership, corporation, trust, or limited liability company, organized on a for-profit basis, which has its principal office located in, or is headquartered in, Washington;
- having as its primary business activity the investment of cash in qualified businesses; and
- certified by the Department of Community, Trade, and Economic Development (DCTED) as meeting the requirements of this new chapter.

A "qualified business" for purposes of CAPCO investment must be independently owned and operated and meet several requirements. It must be headquartered in Washington, have its principal business operation here, have at least 50 percent of its employees in the state, there must be a reasonable expectation that it will remain in Washington for at least three years after the qualified investment, and the qualified business must spend substantially all of the investment within this state. To be "qualified" the business must be a small business as defined in the Regulatory Fairness Act which requires that the business be owned and operated independently from other businesses and have 50 or fewer employees. There are certain businesses and professions which do not qualify, including doctors, lawyers, accountants, banking, insurance, and real estate development. Generally, it is the nature and size of the business at the time that it is first classified as a qualified business that is determinative of whether it can continue to receive qualified investments. An exception to this is made if the business relocates out of state or does not expend substantially all of the investment in this state, in which case it could not receive further qualified investments.

Insurers are allowed a credit against their premium tax in an amount equal to 100 percent of their investment of certified capital in a certified capital company. The total amount of certified capital for which tax credits may be allowed is \$100 million. The total premium tax credit taken statewide each year cannot exceed \$10 million.

Decertification of a CAPCO causes the disallowance and the recapture of the premium tax credit together with interest, but not penalties. The amount of the disallowance depends upon when the decertification occurs. There are also provisions which preclude the tax credit from being taken if the insurer, individually or through its affiliates, manages or controls the CAPCO.

The DCTED is authorized to make rules governing the application procedure to become a CAPCO. Certain parameters are set forth in the bill with respect to what is required, including the payment of a nonrefundable application fee of \$7,500 and specified capitalization requirements.

Any offering materials put forth by the CAPCO is required to include specific language indicating that by certifying the CAPCO the state is not endorsing it and is not liable for damages or losses that an investor may sustain.

To continue to be eligible for certification, a CAPCO must make qualified investments of at least 25 percent within two years of the allocation date and 50 percent within five years of the allocation date. A CAPCO is required to notify the DCTED before investments are made so that a determination can be made whether the business is "qualified." While a CAPCO may place capital in other than qualified businesses, if it has not placed 100 percent in qualified investments within 10 years, the CAPCO shall no longer be permitted to receive management fees.

There are specific reporting requirements with which a CAPCO must comply. These requirements include disclosure of: the certified investors from whom the certified capital was received, including insurance tax identification number; the amount of certified capital; all qualified investments and whether any of these were placed in distressed rural or urban areas; audited financial statements. An annual fee of \$5,000 is also required.

A CAPCO may make qualified distributions at any time. Qualified distributions include reasonable costs of formation, management fees, and fees for professional services. Other distributions can only be made if the aggregate cumulative amount of all qualified investments equals or exceeds 100 percent of its certified capital. Of this amount, 25 percent must have been invested in minority and women's businesses and 25 percent in qualified rural investments.

The CAPCOs are subject to an annual review by the DCTED. Once a CAPCO has invested an amount cumulatively equal to 100 percent of its certified capital in qualified investments, and has met all other requirements, it is no longer subject to such regulation. Certification can be revoked for any material representation or if the application materially violates any of the reporting requirements.

The DCTED is to report to the Legislature and the Governor each year beginning on June 1, 2007 with respect to: the number of CAPCOs; the amount of capital that the certified capital has leveraged; the total amount of tax credits; the total gross number of jobs created by has leveraged; the total amount of tax credits; the total gross number of jobs created by certified capital investments; the location of the qualified businesses in which there has been investment; and which CAPCOs have been decertified and for what reason.

Rulemaking authority is given to the DCTED and by December 1, 2005, the DCTED must submit proposed rules to the Legislature. The rules will not take effect until the effective date of the remainder of the bill, which is established as July 1, 2006.

## **Substitute Bill Compared to Original Bill:**

Rulemaking authority is given to the DCTED rather than the Office of the Insurance Commissioner. By December 1, 2005, the DCTED is to have prepared proposed rules to implement the provisions of the bill and reported these to the Legislature. The rules will not take effect until the effective date of the remainder of the bill, which is established as July 1, 2006. There is a null and void clause added which provides that the entire act is null and void if it is not mentioned in the 2006 budget.

The annual fee required of each CAPCO is increased from \$500 to \$5,000. If not paid by April 1, the fee increases to \$10,000 for that year. Additional restrictions are placed on distributions made by CAPCOs prior to investing 100 percent of their certified capital.

The total amount of certified capital for which tax credits may be allowed remains at \$100 million and the total premium tax credit taken statewide each year cannot exceed \$10 million, as in the original bill, but there are more specific allocation provisions included in the substitute bill which spell out the order in which the tax credits are to be allocated and what happens if two or more CAPCOs file allocation claims on the same day which, in total, exceed the limit. The substitute specifically allows the transfer or sale of tax credits. Such transfer does not effect the time schedule for claiming the credits.

A CAPCO is required to make investments of at least 25 percent of its certified capital into minority and women owned businesses and another 25 percent must be in qualified rural investments. The DCTED is to define, by rule, what constitutes a minority and women owned business and a qualified rural investment for purposes of this bill.

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**Appropriation:** None.

**Fiscal Note:** Available. New fiscal note requested on March 2, 2005.

**Effective Date of Substitute Bill:** The bill takes effect July 1, 2006, except section 11, relating to rules to implement the bill, which takes 90 days after adjournment of session in which bill is passed. However, the bill is null and void if not funded in the budget.

**Testimony For:** Small businesses have a need for capital and this is a need which this bill addresses. The Washington Constitution forbids the lending of credit so the state cannot just make a loan. The tax writeoff allowed to insurance companies will be gradual, over a number of years. The CAPCO money has the potential to leverage more money. A number of amendments are currently being worked on which would give rulemaking and regulatory authority to the Department of Community, Trade, and Economic Development rather than the Office of the Insurance Commissioner and would require that the rules be written before the tax credits are authorized. There need to be strong accountability provisions. There is no guarantee that the state will receive a direct financial return. In other states, the return to the state has more often been in the form of economic development and job creation which then generates tax revenue. CAPCOs have worked in several other states. In addition to supplying

venture capital, the CAPCOs may provide help with management and training. Small businesses that aren't able to borrow from banks have been helped and CAPCO money can bring banks into the mix too because then there is something there for the banks to loan against. The reason CAPCOs are organized for-profit rather than as non-profits is because then there is financial incentive. CAPCOs do not see any return, however, until one hundred percent of the money has been invested in small businesses. At this point, the only fiscal impact would be for the rulemaking. CAPCOs differ from big venture capital firms in that the money must stay within the state and often it is required that a certain percentage of the money be invested in disadvantaged or rural areas or with women or minority owned businesses. There is a risk to a small business owner that takes CAPCO money that the lenders may not be happy with the management and the original small business owner is replaced.

(With concerns) The underlying purpose is admirable but concern is expressed that the tax credits would result in a decrease in the general fund which is already short of money for important programs such as child care and health care.

**Testimony Against:** None.

**Persons Testifying:** (In support) Representative P. Sullivan, prime sponsor; Randy Ray and Seth Cohen, Newtek Business Services.

(With concerns) Lonnie Johns-Brown, National Organization of Women.

**Persons Signed In To Testify But Not Testifying:** None.