

SESSION OF 2017

**SUPPLEMENTAL NOTE ON HOUSE BILL NO. 2168**

As Amended by House Committee of the Whole

**Brief\***

HB 2168, as amended, would create the *Ad Astra* Rural Jobs Act, which would authorize nonrefundable tax credits applicable to income, premiums, or privilege taxes for taxpayers who contribute capital to an “approved investment company” to fund a “rural business concern” in a “rural area,” as those terms would be defined in the bill. Beginning in tax year 2020, 20 percent of the tax credit could be claimed annually over a five-year period. The amount of tax credits claimed in any one fiscal year would not exceed \$20 million, exclusive of the tax credit amounts carried forward. Tax credits would not be transferable except to an “affiliate,” as that term would be defined in the bill.

The tax credit would sunset on December 31 of the sixth year following the effective date of the bill.

***Approval Process for Investment Companies***

Starting January 1, 2018, investment companies could seek registration from the Secretary of Commerce (Secretary) to become an approved investment company by providing the following information:

- The amount of “growth capital,” as that term would be defined in the bill, sought by the applicant;
- Evidence of either:
  - A federally licensed rural business investment company or a small business investment

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\*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

company, demonstrating the applicant or its affiliates have invested a minimum amount, as required by rules and regulations that would be promulgated by the Secretary, in “operating companies,” as that term would be defined in the bill; or

- A minimum amount invested, as required by rules and regulations that would be promulgated by the Secretary, by the applicant or its affiliates in operating companies through federal or state tax credit programs administered by a Kansas agency, provided the applicant has been domiciled in Kansas for three years preceding its application;
- An estimate of the number of jobs to be created or retained as a result of the applicant’s funding;
- A ten-year business plan for the applicant’s funding that would include:
  - A revenue impact assessment prepared by a nationally recognized, third party, independent economic forecasting firm, which would be approved by the Secretary; and
  - A projection of state and local tax revenue to be generated by the applicant’s funding;
- An affidavit from each investor, stating a commitment to make a specified “credit-eligible capital contribution,” as that term would be defined in the bill, in support of the business plan; and
- Other information as required by the Secretary.

The applicant would pay a nonrefundable fee that would not exceed \$5,000. The Secretary would deposit application fees and penalties into the *Ad Astra* Rural Jobs Fund, which

would be an interest-bearing fund created in the state treasury. The Fund would be used to administer the tax credit program.

The Secretary would have 60 days to make application determinations but would be required to act on the applications in the order received from investment companies. The Secretary would be prohibited from approving more than \$166,666,666 in growth capital and \$100 million in credit-eligible contributions. No application seeking more than one-third of these amounts would be approved. Under the following conditions, the Secretary would be required to deny an application:

- The application fee is not paid in full;
- The application does not provide the information described above;
- The revenue impact does not demonstrate the business plan would result in a positive economic impact in rural areas of Kansas over a ten-year period that exceeds the cumulative amount of tax credits the applicant seeks;
- Commitments for:
  - Credit-eligible capital contributions do not equal a minimum of 60 percent of the capital sought under the applicant's business plan; or
  - Equity investments do not equal a minimum of 10 percent of the total growth capital sought; or
- The maximum amount of growth capital and credit-eligible capital contributions have been approved.

Applicants would have 15 days to correct any defect, and the Secretary would have 30 days to consider additional information. When an applicant is approved, the Secretary would specify the amount of growth capital.

### ***Investments Made by Approved Investment Companies***

Within 60 days of receiving approval, the investment company would collect cash and investment contributions from investors listed in the application. If an investment company were to fail to collect the funds, the approved amounts would lapse and either would be prorated to those investment companies granted less than their requested capital amounts or re-awarded to new applicants. Prior to investing in a business, the investment company would request a written opinion from the Department of Commerce (Department) stating whether the business is a “rural business concern,” as that term would be defined in the bill. The Department would have 30 days to respond. If the Department failed to respond, the business would be considered a rural business concern.

Two years after an investment’s “closing date,” which would be defined in the bill, an approved investment company would submit annual reports to the Department that would contain:

- Bank statements evidencing each funding;
- The name and location of each business receiving funding, including evidence that the business qualified as a rural business concern at the time the investment was made;
- The number of employment positions created or retained as a result of the investment company’s funding as of December 31 of the preceding year; and
- Other information deemed necessary by the Department.

### ***Clawback Provisions***

The Secretary would be required to revoke a tax credit certificate if the approved investment company:

- Does not invest 100 percent of its growth capital in funding within two years of the closing date;
- Fails to maintain the investment for five years after the closing date. An investment sold or repaid, in whole or in part, would be deemed maintained if the investment company reinvests an amount equal to the returned or recovered portion, excluding any profits realized, in other funding within 12 months of the receipt of the returned or recovered portion;
- Makes a distribution or payment that results in the approved investment fund having less than 100 percent of its growth capital invested in fundings or available for investments in fundings and held as cash or marketable securities;
- Invests more than 20 percent of its capital growth in the same rural business concern, including amounts invested in affiliates of that business concern;
- Invests funding in a rural business concern that directly or indirectly owns, has the right to acquire an ownership interest in, makes a loan to, or makes an investment in the investment company, its affiliates or investors. This provision would not apply to investments made by rural business concerns in publicly traded securities; or
- Invests funding in a rural business concern that fails to meet or maintain an agreed location of its "principal business operations," as that term would be defined in the bill.

Prior to revoking a tax credit, the Secretary would give notice to the approved investment company to correct the violations within 90 days of receiving notice. For each day after 90 days it takes to correct a violation, the investment company would be charged \$5,000 per day.

After five calendar years from the closing date, an approved investment company could leave the program if none of its tax credits were revoked or pending revocation. By the date of the proposed distribution, if the number of jobs created or retained by the rural business is:

- Less than 60 percent of the amount projected in the business plan, the State would receive 30 percent of any distribution to an equity holder in the approved investment fund in excess of the sum of equity capital invested and the projected increase associated to the equity holder's federal or state tax liability, including penalties and interest;
- Greater than 60 percent but less than 100 percent of the amount projected in the business plan, the State would receive 15 percent of any distribution to an equity holder in the approved investment fund in excess of the sum of equity capital invested and the projected increase associated to the equity holder's federal or state tax liability, including penalties and interest; or
- Equal to or greater than 100 percent, the State would receive 0 percent.

Funds collected from clawback provisions would be deposited in the *Ad Astra* Rural Jobs Fund. The Secretaries of Revenue and Commerce would be granted discretionary authority to promulgate rules and regulations.

**Definitions**

The bill would provide the following substantive definitions for terms:

- "Affiliate" would mean a person that directly or indirectly is controlled by another person or entity. A person would be controlled by another person if the

controlling person holds, directly or indirectly, the majority voting or ownership interest or has control over the day-to-day operations;

- “Approved investment company” would mean a person, excluding an individual, seeking to make successful development venture capital investments in rural business concerns that will create wealth and job opportunities in identified rural areas and that have been approved by the Secretary pursuant to the bill;
- “Closing date” would mean the date all committed investments are collected by an approved investment company;
- “Credit-eligible capital contribution” would mean a cash investment in an approved investment company made:
  - For an equity investment in the investment company; or the purchase of debt issued by the investment company; and
  - By a person subject to various Kansas taxes;
- “Growth capital” would mean the total of cash investments in an approved investment company, including credit-eligible capital contributions from investors and other cash equivalents, including government grants, guaranteed debenture funds, or other public funds, in the amount approved by the Secretary. At least 60 percent of growth capital would be comprised of credit-eligible capital contributions. At least 10 percent of growth capital would be comprised of equity investments contributed by affiliates of the approved investment company, including employees, officers, and directors of the affiliates;
- “Operating company” would mean a person either doing business in Kansas or seeking to do

business in Kansas and which is not a publicly traded business;

- “Principal business operations” would mean the location where at least 60 percent of a company’s employees work or where employees are paid at least 60 percent of the company’s payroll. An operating company, whose principal business is not in Kansas, that has agreed to move the location of its principal business operations using the proceeds of its funding for a purpose of meeting the definition of a rural business concern would be deemed to have its principal business operations in the new location within 180 days after funding;
- “Rural area” would mean a location:
  - That is not within a city with a population greater than 60,000 or within the urbanized area adjacent to the city; or
  - Determined to be a rural area by the Secretary upon consideration of the following nonexclusive factors:
    - Population density, density of commercial development, and availability of non-farm employment; or
    - Attachment to an urbanized area by a contiguous area of urbanized U.S. Census blocks that would be no more than two blocks wide; and
- “Rural business concern” would mean an operating company that:
  - Has its principal business operations in one or more rural areas in Kansas;
  - Has fewer than 500 employees or had an average federal adjusted gross income of less than \$15 million in the three preceding tax years; and

- Engages in industries related to manufacturing, plant sciences, technology, or agricultural technology. The Secretary would be allowed to include operating companies in other industries if the determination has been made that the economic growth would be highly beneficial for the state and the rural area in which the company is or will be located.

## **Background**

The bill was introduced by Representatives Waymaster, Claeys, Concannon, Davis, and Hoffman. During the hearing before the House Committee on Commerce, Labor and Economic Development, Representative Waymaster and representatives from various economic development corporations and agricultural associations testified in favor of the bill, explaining the legislation would compliment the Rural Opportunity Zone Program by encouraging job growth in rural areas. A representative from a venture capital firm also spoke in favor of the bill, stating the legislation contained several best practices, including taxpayer protections, economic impact standards, and federal licensing of investment companies.

There was no opponent or neutral testimony.

On February 20, the House Committee amended the bill to:

- Revise the definition for “growth capital,” requiring 60 percent instead of 40 percent to be comprised of credit-eligible capital contributions;
- Limit the total amounts of growth capital and credit-eligible capital contributions that may be approved by the Secretary to \$166,666,666 and \$100 million, respectively; and

- Specify in a clawback provision the actual revenue impact would be quantified in terms of jobs created or retained by a rural business concern.

On February 23, the bill was referred from the House to the Committee on Appropriations. Later that day, the bill was rereferred to the Committee on Taxation. On March 8, the bill was rereferred to the Committee on Commerce, Labor and Economic Development. On March 9, the House Committee on Commerce, Labor and Economic Development recommended the bill be passed with the amendments that it had proposed previously.

On March 14, the House Committee of the Whole amended the bill to clarify the definition of “principal business operations” by specifying that the company moving its business operations would be moving from out of state into Kansas.

According to the fiscal note prepared by the Division of the Budget, in consultation with the departments of Commerce and Revenue, the bill as introduced would cap tax credits at \$20 million per fiscal year beginning in FY 2020. The Department of Revenue indicates the bill would require \$237,333 from the State General Fund (SGF) and 2.0 new FTE positions to implement provisions of the bill. The Department of Commerce indicates the bill would require \$375,000 and \$325,000 from the SGF for FY 2018 and FY 2019, respectively; the Department estimates it would require 3.0 new FTE positions, starting in FY 2018, to administer provisions of the tax credit program. No additional fiscal analysis was available at the time the House Committee recommended the bill, as amended, be passed.