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**Community & Economic  
Development & Trade Committee**

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**HB 1721**

**Brief Description:** Creating certified capital companies to promote economic development through investment in start-up and emerging businesses.

**Sponsors:** Representatives P. Sullivan, Pettigrew, Kristiansen, Orcutt, Chase, Skinner, Haler, Roach, Morrell, Linville, Eickmeyer, Kessler, Walsh, Dunn, Kenney, VanDeWege and Simpson.

**Brief Summary of Bill**

- Authorizes the creation of certified capital companies (CAPCOs) to promote investment in Washington's small businesses.
- Allows premium tax credits for insurance companies that make qualified investments in CAPCOs.

**Hearing Date:** 2/14/07

**Staff:** Tracey Taylor (786-7196).

**Background:**

Several states, including Louisiana, New York and Missouri, have authorized the creation of certified capital companies (CAPCOs) which provide venture capital to small businesses in those states. A CAPCO must make direct financial investments into small businesses and work with entrepreneurs to grow these businesses. Additional capital may be attracted to these small businesses due to the CAPCOs' initial investments, thereby leveraging the original dollars.

Investments in CAPCOs are attractive to insurance companies due to the premium tax credit authorized in return for making qualified investments. In Washington, all insurers except title insurers pay a 2 percent tax on premiums.

**Summary of Bill:**

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

A new chapter is created in Title 43 related to CAPCO investments. A CAPCO is defined as: a partnership, corporation, trust or limited liability company, organized on a for-profit basis, which has its primary office located or is headquartered in Washington; has as its primary business activity the investment of cash in qualified businesses; and is certified by the Department of Community, Trade and Economic Development (DCTED).

A CAPCO must invest in a qualified business, which is defined a business that: is independently owned and operated; headquartered in Washington and its principal business operations located in Washington; having at least 50 percent of its employees in Washington; not more than 100 total employees; and is unable to obtain conventional financing. In addition, a qualified business may not be engaged in professional services, banking or lending, real estate development, insurance, oil and gas exploration, direct gambling activities, or making loans to or investments in CAPCOs or an affiliate. A qualified business may not be a franchise of or organized by a CAPCO or CAPCO affiliate. Generally, it is the size and nature of the business at the time it is first classified as a qualified business that is determinative of whether it can continue to receive qualified investments. However, if a business has relocated its headquarters or principal business operation outside of Washington, it will lose its qualified business designation. Also, if the business has expended less than 75 percent of the funds from its prior qualified investments have been used to establish and support its Washington operations, it will lose its qualified business designation.

An insurer earns a vested tax credit against their premium tax liability equal to 75 percent of its CAPCO investment. An insurer is entitled to take the vested tax credit according to the following schedule:

Year 2008:	20 percent
Year 2009:	20 percent
Year 2010:	20 percent
Year 2011:	5 percent
Year 2012:	5 percent
Year 2013:	5 percent

The total amount of certified capital for which tax credits may be allowed is \$100 million.

Decertification of a CAPCO causes the disallowance and recapture of the premium tax credit along with interest. The amount of the disallowance depends upon the timing of the decertification. 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 CAPCO certification application procedures. An applicant is required to not only file an application with the DCTED, it is also required to pay a nonrefundable application fee of \$20,000, which shall be deposited into the Certified Capital Company Revolving Fund. In addition, a CAPCO applicant must have an equity capitalization of \$500,000 and have at least two principals or two persons employed to manage the funds who have at least two years of money management experience in the venture capital industry.

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.

In order to continue to be eligible for certification, a CAPCO must make qualified investments of at least 25 percent of its certified capital within two years of the allocation date and 50 percent of its certified capital within 5 years of the allocation date. Prior to making an investment, a CAPCO is required to notify the DCTED in order to confirm the investment is being made in a qualified business. A CAPCO must place at least 100 percent of the certified capital allocable to it in qualified investment or it shall no longer be permitted to distribute management fees.

A CAPCO must report to the DCTED as soon as practicable after the receipt of certified capital: the name of each certified investor; the amount of the each certified investor's investment of certified capital; and the date on which the certified capital was received. Annually, a CAPCO must report to the DCTED: the amount of the CAPCO's certified capital at the end of the immediately preceding taxable year; whether or not the CAPCO has invested more than 15 percent of its total certified capital in any one business; all qualified investments that the CAPCO made in the previous year; and other information requested by the DCTED. In addition, a CAPCO must provide the DCTED with annual audited financial statements and an "agreed upon procedures report".

A CAPCO may make qualified distributions at any time. Qualified distributions include the reasonable costs of formation, management fees, and fees for professional services. Other distributions may only be made if the CAPCO can demonstrate that the aggregate cumulative amount of all qualified investments equals or exceeds 100 percent of its certified capital, of which at least 25 percent must have been invested in qualified business or qualified microenterprise development organizations in rural counties or in a city with a population of less than 30,000, and at least 5 percent of the certified capital has been invested in microenterprise development organizations. In addition, to investing in rural counties, small cities and microenterprise development organizations, CAPCOs are encouraged to invest in businesses certified by the Office of Minority and Women's Business Enterprises.

A CAPCO is required to pay to the DCTED an amount equal to 5 percent of all distributions to equity holders of the CAPCO other than qualified distributions and distributions of all equity contributed to the CAPCO by such equity holders. Revenues under this section shall be deposited in the State General Fund and shall be distributed to and supplement state-funded programs which assist businesses with start-up, commercialize research, business education, modernization services and technical services. This includes Washington Manufacturing Services, Washington Technology Center, Spokane Intercollegiate Research and Technology Institute and microenterprise development programs.

Certification can be revoked for any material representation that proves to be falsely made or if the application materially violates any of the reporting requirements.

Upon notification by the Joint Legislative Audit and Review Committee (JLARC), the DCTED shall report to the Governor: the number of CAPCOs holding certified capital; the amount of certified capital invested in each CAPCO; the cumulative amount that each CAPCO has invested as of September 30, 2012, and the cumulative total each year thereafter; the cumulative amount that the investments of each CAPCO have leveraged in terms of capital invested by other sources in qualified businesses at the same time or subsequent to the CAPCO investment; the total number of tax credits granted for each year; the performance of each CAPCO with regard to the requirements for continuing certification; the classification of the companies in which each

CAPCO has invested according to industrial sector and size of company; the total gross number of jobs created by CAPCO investments and the number of jobs retained; the location of the companies in which each CAPCO invested; the total amount invested in qualified microenterprise development organizations, the number of small businesses that received financial assistance from these organizations and the number of jobs created and retained by such businesses; the total amount invested in businesses that are certified minority or women-owned and controlled businesses; those CAPCOs that have been decertified or revoked and the reason for the decertification or revocation; and any other information requested by the JLARC.

It is the intent of the bill that the CAPCO fees shall be sufficient to pay the reasonable costs associated with regulating the CAPCOs. In addition to the registration fee, the DCTED shall annually estimate the cost of administering the program including the expenses related to the employment of one full-time equivalent. The DCTED shall annually assess a fee on each CAPCO to recoup such expenses.

The DCTED may develop any rules necessary for the implementation of this program.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill contains an emergency clause and takes effect immediately.