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Reported by Representative Bell from the Committee on State Government. Printed under Joint Rules No. 2.
EDWIN H. PERT, Clerk

STATE OF MAINE

IN THE YEAR OF OUR LORD NINETEEN HUNDRED AND EIGHTY-ONE

AN ACT to Authorize and Encourage Risk Capital Funds.

Be it enacted by the People of the State of Maine, as follows:

Sec. 1. 10 MRSA c. 109 is enacted to read:

CHAPTER 109
RISK CAPITAL FUND

§ 971. Statement of legislative findings and intent

The Legislature finds that one of the limiting factors of the beneficial economic development of the State is the limited availability of investment capital for financing the development and growth of Maine businesses. This lack of investment capital for new and existing businesses may inhibit otherwise viable business expansion and may also force businesses to use financing techniques which impede capital reinvestment, thus shifting the focus from long-term growth to short-term survival.

This impediment to the development and expansion of viable Maine businesses affects all the people of Maine adversely and is one factor resulting in existing conditions of unemployment, underemployment, low per capita income and resource underutilization. By restraining economic development, it sustains burdensome pressure on State Government to provide services to those citizens who are unable to provide for themselves.

To help correct this situation, it is appropriate to use the profit motive of private investors to achieve additional economic development in the State. This can be accomplished by authorizing the establishment of private funds to provide investment capital to existing and proposed Maine firms with growth potential; and by establishing limited tax credits for investors in the corporation to encourage the formation and use of private capital for the critical public purposes of maintaining and strengthening the state's economy.

§ 972. Formation; purposes

The formation of risk capital funds is authorized for the purpose of providing debt and equity investment capital to new Maine business firms or existing Maine business firms. A risk capital fund may be formed as a private investment corporation under Title 13-A or as a private investment limited partnership under Title 31, chapter 7. In order to benefit under this chapter such corporation or partnership shall acquire and maintain a Small Business Investment Company license pursuant to the United States Small Business Investment Act of 1958 Public Law 85-699, as amended.

§ 973. Limitations on purposes and powers

A risk capital fund shall have all of the general powers of business corporations enumerated in Title 13-A, section 202, if a corporation, and all of the general powers of a limited partnership enumerated in Title 31, chapter 7, if a limited partnership, subject to the following provisions.

1. Investments and related business dealings. A risk capital fund's financing shall be restricted to Maine business firms, as defined in subsection 2. The proceeds of any such financings with Maine business firms, by purchase of stock or otherwise, shall be used by the firms solely for the purpose of enhancing their productive capacities or ability to do business within the State or to facilitate their ability to generate value added within the State to goods or services. A risk capital funds's financings may include, in any combination and without limitation, equity investments, loans, guarantees and commitments for such financings.

2. Maine business firm. A "Maine business firm" is a business entity, including without limitation a corporation or a limited partnership, whether or not a subsidiary of a foreign corporation, which:

A. Derived at least 60% of its gross revenues and those of its subsidiaries on a consolidated basis in its most recent fiscal year from the operation of a business located in this State or from the rendering of services in this State;

B. Had at the end of its most recent semiannual fiscal period at least 60% of its tangible assets and those of its subsidiaries on a consolidated basis located in this State; or

C. At the time of its financing with a risk capital corporation employed in this State at least 60% of its employees and those of its subsidiaries.

3. Investment limited. A risk capital fund's total investment in any one

Maine business firm shall be limited to a maximum of 20% of the stockholders' equity or partner's equity investment of the risk capital firm. A risk capital fund shall not invest in any firm in which a person, or his spouse or dependent children, owning common stock of that risk capital fund holds over a 25% interest.

4. Credit limited. The maximum credit that may be claimed against taxes due the State under Title 36 over any period of time by any taxpayers for any qualified investment for a single fund shall be $500,000, to be allocated pro rata among the taxpayers.

5. Judgments conclusive. In the absence of fraud or bad faith in the transaction, the judgment of the board of directors, shareholders or partners, as the case may be, of a risk capital fund as to the status of an entity as a Maine business firm or as to the purposes for which the proceeds of a financing are to be used by a Maine business firm shall be conclusive. In making that judgment the directors, shareholders or partners, as the case may be, shall be entitled to rely upon affidavits or covenants, or both, furnished by the Maine business firm.

6. Amount of common stock held. No person, firm or corporation may own more than 10% of the equity of a risk capital fund. For the purposes of determining ownership under this chapter, the constructive ownership rules of the United States Internal Revenue Code of 1954, United States Code, Title 26, Section 318, as amended, in effect as of the effective date of this chapter apply.

7. Payment of dividends. A risk capital fund shall not declare or pay any dividends to its shareholders or pay any share of profits to its partners during its first 5 years of operation. Dividends or share of profit paid in any fiscal year shall be limited to a maximum of 50% of accumulated retained earnings as of the end of the next preceding fiscal year, with the balance being retained by the fund to be reinvested according to subsections 1 and 2.

8. Financial statement. A risk capital fund shall cause to be prepared an audited financial statement, certified by an independent certified public accountant, within 90 days after the close of each fiscal year of its operations, which report shall be made available to the Bureau of Taxation, detailing its investment and financial activities.

§ 974. Approval of Commissioner of Business Regulation

In order to provide for the initial organization of any fund a committee shall be established, consisting of 5 individuals who shall act as incorporators in the case of a proposed corporation or of 2 or more persons who shall act as formers of the partnership in the case of a limited partnership. The committee shall file with the Secretary of State the articles of incorporation of the corporation or the certificate of limited partnership, which shall reflect the purposes set forth in this section. The committee, or the directors of the corporation or partners of the limited partnership if then in office, shall further submit to the Commissioner of Business Regulation, for his approval of their conformity with the limitations set forth in section 973, the proposed bylaws of the corporation or limited partnership, which may not be adopted or later amended without his approval.

§ 975. Commencement of business

A risk capital fund shall not commence business until its bylaws have been approved as provided in section 974 and until it has at least $500,000 of equity capital from the issuance of common stock of the corporation or $500,000 of equity investment in the limited partnership.

Sec. 2. 36 MRSA § 2520-A is enacted to read:

§ 2520-A. Credit for investment in a risk capital fund

1. Amount of credit. A taxable company or association which is the original holder of stock in a risk capital fund shall be allowed a credit against the tax otherwise due under section 2511, 2513, 2517 or 2520 for the taxable year equal to 50% of that taxpayer's qualified investment during that taxable year in a risk capital fund. For purposes of this section, the term "qualified investment" means the original purchase price to the taxpayer of stock in a corporation or the original equity investment by the taxpayer in a limited partnership.

2. Limitations on credit. For any one taxable year, the amount of the credit which a taxpayer may claim against the tax otherwise due under this Part shall not exceed the lesser of:

A. 10% of the qualified investment of that taxpayer; or

B. 50% of the tax imposed on that taxpayer for that taxable year.

3. Carry forward of the credit. If the amount of the credit determined under subsection 1 exceeds the limitations provided in subsection 2, the excess shall be a credit carryover to each taxable year of that taxpayer following that taxable year. The credit provided in subsection 1 with respect to a qualified investment shall expire as of the end of the 8th taxable year of the taxpayer following the year in which that taxpayer made that qualified investment.

4. Recapture for certain dispositions. If the taxpayer disposes of the stock or withdraws the equity investment in a risk capital fund within 6 years after the date on which the taxpayer acquired the stock or made the equity investment in a transaction which gives rise to gain or loss for federal income tax purposes, then the tax imposed under this Part for the taxable year in which the disposition or withdrawal occurs shall be increased by an amount equal to the sum of the amounts of the credit allowable under this section and claimed by that taxpayer in the year of disposition or withdrawal and all prior years as offsets against the tax otherwise due under section 2511, 2513, 2517 or 2520 from that taxpayer.

Sec. 3. 36 MRSA § 5131 is enacted to read:

§ 5131. Credit for investment in a risk capital fund

1. Amount of credit. A resident individual who is the original holder of stock or an original equity investor in a risk capital fund shall be allowed a credit against the tax otherwise due under this Part for the taxable year equal to 50% of

that taxpayer's qualified investment during that taxable year in a risk capital fund. For the purposes of this section, the term "qualified investment" means the original purchase price to the taxpayer of stock in a corporation or the original equity investment by the taxpayer in a limited partnership.

2. Limitation on credit. For any one taxable year, the amount of the credit which a taxpayer may claim against the tax otherwise due under this Part shall not exceed the lesser of:

A. 10% of the qualified investment of that taxpayer; or

B. 50% of the tax imposed on that taxpayer for that taxable year.

3. Carry forward of the credit. If the amount of the credit determined under subsection 1 exceeds the limitations provided in subsection 2, the excess shall be a credit carryover to each taxable year of that taxpayer following that taxable year. The credit provided in subsection 1 with respect to a qualified investment shall expire as of the end of the 8th taxable year of the taxpayer following the year in which that taxpayer made that qualified investment.

4. Recapture for certain dispositions. If the taxpayer disposes of the stock or withdraws the equity investment in a risk capital fund within 6 years after the date on which the taxpayer acquired the stock or made the equity investment in a transaction which gives rise to gain or loss for federal income tax purposes, then the tax imposed under this Part for the taxable year in which the disposition or withdrawal occurs shall be increased by an amount equal to the sum of the amounts of the credit allowable under this section and claimed by that taxpayer in the year of disposition or withdrawal and all prior years as offsets against the tax otherwise due under this Part from that taxpayer.

Sec. 4. 36 MRSA § 5168 is enacted to read:

§ 5168. Credit for investment in a risk capital fund

1. Amount of credit. A resident estate or trust which is the original holder of stock or an original equity investor in a risk capital fund shall be allowed a credit against the tax otherwise due under this Part for the taxable year equal to 50% of that taxpayer's qualified investment during that taxable year in a risk capital fund. For purposes of this section, the term "qualified investment" means the original purchase price to the taxpayer of stock in a corporation or the original equity investment by the taxpayer in a limited partnership.

2. Limitations on credit. For any one taxable year, the amount of the credit which a taxpayer may claim against the tax otherwise due under this Part shall not exceed the lesser of:

A. 10% of the qualified investment of that taxpayer; or

B. 50% of the tax imposed on that taxpayer for that taxable year.

3. Carry forward of the credit. If the amount of the credit determined under subsection 1 exceeds the limitations provided in subsection 2, the excess shall be a

credit carryover to each taxable year of that taxpayer following that taxable year. The credit provided in subsection 1 with respect to a qualified investment shall expire as of the end of the 8th taxable year of the taxpayer following the year in which that taxpayer made that qualified investment.

4. Recapture for certain dispositions. If the taxpayer disposes of the stock or withdraws the equity investment in a risk capital fund within 6 years after the date on which the taxpayer acquired the stock or made the equity investment in a transaction which gives rise to gain or loss for federal income tax purposes, other than a distribution of that stock to a beneficiary of such estate or trust, then the tax imposed under this Part for the taxable year in which the disposition or withdrawal occurs shall be increased by an amount equal to the sum of the amounts of the credit allowable under this section and claimed by that taxpayer in the year of disposition or withdrawal and all prior years as offsets against the tax otherwise due under this Part from that taxpayer.

Sec. 5. 36 MRSA § 5202-B is enacted to read:

§ 5202-B. Credit for investment in a risk capital fund

1. Amount of credit. A taxable corporation which is the original holder of stock or an original equity investor in a risk capital fund shall be allowed a credit against the tax otherwise due under this Part for the taxable year equal to 50% of that taxpayer's qualified investment during that taxable year in a risk capital fund. For purposes of this section, the term "qualified investment" means the original purchase price to the taxpayer of stock in a corporation or the original equity investment by the taxpayer.

2. Limitations on credit. For any one taxable year, the amount of the credit which a taxpayer may claim against the tax otherwise due under this Part shall not exceed the lesser of:

A. 10% of the qualified investment of that taxpayer; or

B. 50% of the tax imposed on that taxpayer for that taxable year.

3. Carry forward of the credit. If the amount of the credit determined under subsection 1 exceeds the limitations provided in subsection 2, the excess shall be a credit carryover to each taxable year of that taxpayer following that taxable year. The credit provided in subsection 1 with respect to a qualified investment shall expire as of the end of the 8th taxable year of the taxpayer following the year in which that taxpayer made that qualified investment.

4. Recapture for certain dispositions. If the taxpayer disposes of the stock or withdraws the equity investment in a risk capital fund within 6 years after the date on which the taxpayer acquired the stock or made the equity investment in a transaction which gives rise to gain or loss for federal income tax purposes, then the tax imposed under this Part for the taxable year in which the disposition or withdrawal occurs shall be increased by an amount equal to the sum of the amounts of the credit allowable under this section and claimed by that taxpayer in

the year of disposition or withdrawal and all prior years as offsets against the tax otherwise due under this Part from that taxpayer.

Sec. 6. **36 MRSA § 5206, sub-§ 1,** as amended by PL 1977, c. 587, § 5, is further amended to read:

1. **Rate.** 4.95% of taxable income not in excess of $25,000, plus 6.93% of the taxable income in excess of $25,000 attributable on or after January 1, 1978, provided that taxable income, for purposes of this subsection, shall be reduced by the amount of the corporation's or association's federal new jobs credit for tax years beginning on or after January 1, 1978; shall be reduced by the amount of the corporation's or association's credit for investment in the Maine Capital Corporation for tax years beginning on or after January 1, 1979; **shall be reduced by the amount of the corporation's or association's credit for investment in a risk capital fund established pursuant to Title 10, chapter 109**; and is reduced by the amount of the tax payable by the corporation or association for the taxable year under chapter 817.

Sec. 7. Sections 2 to 6 shall take effect on July 1, 1982.

FISCAL NOTE

The bill is expected to have a positive overall revenue impact on the State. Its sole cost to the State results from partial tax credits for investments in risk capital corporations, which are in turn required to invest in the development of Maine businesses. These tax credits could result in up to $144,000 per year in lost revenue to General Fund, not to exceed $500,000 over 5 years per corporation formed. This revenue loss may be offset by taxes received from income and property created by the investment of the funds and to the extent that credit eligible investments are made with funds previously in tax shelters. Such reinvestment generally has a "multiplier effect" greater than the underlying investment, which is represented by increased employment, property tax, income tax, and so forth, and therefore in excess of the tax credit for the "seed money."

STATEMENT OF FACT

Several years ago, legislation was enacted creating the Maine Capital Corporation. The purpose was to provide a quasi-public corporation to attract funds to be used to finance the establishment and growth of Maine businesses.

The bill authorizes groups of businesses or individuals to establish entirely private risk capital funds and provides tax incentives for participating in such corporations. The purpose is the same as for the Maine Capital Corporations: To attract funds for financing establishment and growth of Maine businesses. The reasons for the entirely private corporations are: The Maine Capital Corporation is fully subscribed and therefore unable to increase its investments — this will provide a vehicle for additional investment; to make available entirely private mechanisms for those who may not wish to invest in a quasi-public corporation; and to provide incentives and opportunities for innovations in financing these ventures.

The funds authorized and the tax incentives in this bill are very similar to the structure and function of the Maine Capital Corporation and the tax incentives relating to it.

A risk capital fund will have all the general powers of business corporations or limited partnerships enumerated in the Revised Statutes, except for several provisions designed to safeguard the public interest. These include provisions which:

1. Restrict the investment of a risk capital fund to Maine businesses only;

2. Limit the maximum amount of any one investment to 20% of a risk capital fund's stockholders' or partner's equity;

3. Require an audited financial statement, to be available to the Bureau of Taxation;

4. Prohibit any distribution of earnings for 5 years; after 5 years dividends would be limited to a maximum of 50% of retained earnings, with the balance being reinvested in Maine businesses;

5. Prohibit the fund from investing in any firm in which a person or corporation owning common stock of the corporation holds over a 25% interest; and

6. Require the fund to become a small business investment company pursuant to federal law.

As an incentive to mobilize the required capital, a limited tax credit will be offered to those Maine income taxpayers who invest in a fund. This credit will be for up to 10% of an investor's investment in a fund each year for 5 years, with a maximum of 50% of the investment, provided the credit never exceeds 50% of the taxpayer's Maine tax liability. The maximum credit that may be claimed over any period of time for any qualified investments by any taxpayer is limited to $500,000.