

HOUSE BILL NO. 770
INTRODUCED BY N. FRITZ

A BILL FOR AN ACT ENTITLED: "AN ACT ESTABLISHING A CAPITAL INVESTMENT TAX CREDIT AGAINST INDIVIDUAL INCOME TAX LIABILITY OR CORPORATION LICENSE TAX LIABILITY FOR INVESTING IN CERTAIN INNOVATIVE MONTANA BUSINESSES; DESIGNATING CERTAIN BUSINESS ACTIVITIES AS ELIGIBLE OR INELIGIBLE FOR THE PURPOSES OF THE CAPITAL INVESTMENT TAX CREDIT; PROVIDING FOR THE ADMINISTRATION OF THE CAPITAL INVESTMENT TAX CREDIT; PROVIDING PENALTIES, INCLUDING RECAPTURE, FOR FAILURE TO COMPLY WITH THE CRITERIA REQUIRED FOR ALLOCATION OF THE CAPITAL INVESTMENT TAX CREDITS; IMPOSING LIMITS ON ACCESS TO AND USE OF THE CAPITAL INVESTMENT TAX CREDIT; AND PROVIDING AN EFFECTIVE DATE AND A RETROACTIVE APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

NEW SECTION. **Section 1. Capital investment tax credit -- purpose.** (1) The purpose of [sections 1 through 13] is to promote the development of the human resources and diversification of the economy of Montana. The capital investment tax credit available under [sections 1 through 13] must be used to encourage and assist the strengthening of the economy through loans, equity investments, and other business transactions for purposes of developing innovative, high-growth businesses in Montana and stimulating and assisting in the expansion of innovative, high-growth business activities that promote and maintain the economic stability of the state by providing maximum opportunities for employment of Montanans and improving the standard of living of the people of Montana.

(2) By enacting [sections 1 through 13], it is also the legislature's intent to:

(a) increase the availability of development capital in order to encourage and assist in the creation, development, and expansion of innovative, high-growth businesses based in Montana;

(b) aid those businesses, including businesses owned and operated by women and minorities, to which conventional business financing is not readily or fully available through traditional sources;

(c) develop, preserve, diversify, expand, and strengthen the industrial and business base of Montana's economy, particularly for those innovative, high-growth businesses that employ the state's communications, technical, managerial, and research and development resources; and

(d) provide the residents of Montana with greater opportunities to invest and participate in the economic development and potential of this state.

NEW SECTION. Section 2. Definitions. As used in [sections 1 through 13], unless the context requires otherwise, the following definitions apply:

(1) "Affiliate" means an entity that owns 20% or more of a certified Montana business.

(2) "Certified Montana business" means a Montana business that is qualified by the department, as provided in [section 5], as a certified Montana business so that investors in the business may receive the capital investment tax credits authorized in [sections 1 through 13].

(3) "Department" means the department of revenue.

(4) (a) "Eligible business" means a Montana business that:

(i) generates at least 75% of the business's gross income from operations within Montana that are subject to taxation under Title 15, chapter 30 or 31;

(ii) at the end of the previous tax year, had a net worth of less than \$1 million;

(iii) for the 2 immediately previous tax years, had a mean-average, after-tax, net income of less than \$500,000;

(iv) is not an affiliate of a business that does not meet the limitations stated in subsections (4)(a)(i) through (4)(a)(iii);

(v) derives a maximum of 10% of its gross revenue from ineligible business activities; and

(vi) under rules adopted pursuant to [section 3], generates a high rate of revenue growth or sustainable employment growth.

(b) The term includes manufacturing processes or postproduction activities that add value to agricultural, mining, or forest products if the business meets all of the requirements under subsection (4)(a).

(5) "Equity capital" means an investment:

(a) that conveys to the investor a share of ownership; and

(b) for which the investor does not have:

(i) a right to a predetermined repayment schedule; or

(ii) a preferential claim on the assets of the entity in which the investment was made.

(6) "Ineligible business activity" means a business activity that does not achieve the purposes described in [section 1] and includes but is not limited to any of the following activities:

(a) gaming or gambling;

- (b) retail sales;
 - (c) services provided by traditional service businesses, including:
 - (i) hotels, motels, or other lodging facilities;
 - (ii) restaurants and other entities that are primarily operated for selling prepared food or drink;
 - (iii) amusement parks or facilities;
 - (iv) recreational facilities; and
 - (v) health clubs;
 - (d) banking and financial services;
 - (e) real estate sales or real estate development;
 - (f) services provided by an individual or entity that sells insurance;
 - (g) professional services for which licensure or certification is required under the laws of this state and that are provided to Montana residents or Montana businesses;
 - (h) agricultural production, including silviculture;
 - (i) mining; and
 - (j) logging.
- (7) "Intermediary organization" means:
- (a) an individual;
 - (b) an entity that is licensed as a small business investment corporation by the United States small business administration as provided in Title III of the Small Business Investment Act of 1958, as amended, and as implemented under 13 CFR 107; or
 - (c) an entity that:
 - (i) is exempt from taxation under section 501(c) of the Internal Revenue Code, 26 U.S.C. 501(c);
 - (ii) is incorporated and admitted under the Montana Nonprofit Corporation Act, Title 35, chapter 2; and
 - (iii) invests in an eligible business.
- (8) "Mezzanine debt capital" means an investment:
- (a) that does not convey to the investor any ownership in the entity in which or activity for which the investment is made;
 - (b) that may include a predetermined repayment schedule, with or without a stated rate of interest; and
 - (c) for which the investor's claim to the assets of the entity in which or activity for which the investment was made or to repayment of principal or interest is subordinate to secured lenders.
- (9) "Montana business" means a business that is located or principally based within Montana.

(10) "Qualified investment" means equity capital or mezzanine debt capital:

(a) that is invested in an eligible business;

(b) at least 80% of which is used or is intended to be used to support eligible Montana business activities;

and

(c) that does not displace other sources of equity or debt financing that are available unless the department determines that the investment furthers the purposes of [sections 1 through 13].

NEW SECTION. Section 3. Rulemaking. (1) The department shall adopt rules to implement the provisions of [sections 1 through 13].

(2) At a minimum, the rules must:

(a) describe what constitutes a high rate of growth for revenue or sustainable employment for purposes of identifying a business as an eligible business;

(b) state that the threshold of revenue growth or sustainable employment growth that constitutes high growth for a Montana business applying for qualification as a certified Montana business must be made at the time the applicant's application is under consideration by the department and must be clearly stated to the applicant upon qualification as a certified Montana business; and

(c) identify the information necessary from and provide forms for Montana businesses applying to become qualified Montana businesses.

(3) The department may adopt other rules to implement or administer the provisions of [sections 1 through 13].

NEW SECTION. Section 4. Fees. The department may charge fees commensurate with costs for the administration of [sections 1 through 13]. Fees under this section must be assessed to each certified Montana business in a ratio proportionate to the capital investment tax credits allocated to the certified Montana business divided by the total capital investment tax credits allocated to all certified Montana businesses. The department shall determine the time or times at which payment of the fee is due.

NEW SECTION. Section 5. Qualifying Montana business. (1) An entity seeking to become a certified Montana business shall make written application to the department on forms provided by the department. The application must contain the information required by [section 9] and other information that the department requires.

(2) The application must show that the applicant is engaged or will be engaged within 6 months of the date of application in activities that qualify the applicant as an eligible business.

(3) Applicants eligible to qualify as a certified Montana business include corporations subject to taxation under Title 15, chapter 31, intermediary organizations, small business corporations, as defined in 15-30-1101, and any other Montana business that engages substantially in activities conducted by eligible businesses.

(4) The department shall qualify applicants that accomplish the purposes of and meet the requirements of [sections 1 through 13] as certified Montana businesses.

(5) Qualification by the department as a certified Montana business is a prerequisite to and must be completed before seeking an allocation of the capital investment tax credits allowed under [sections 1 through 13].

NEW SECTION. Section 6. Certified Montana business. (1) The department shall maintain a current list of all entities that are certified Montana businesses under [sections 1 through 13].

(2) (a) The maximum amount of capital investment tax credits authorized for a single certified Montana business may not exceed \$250,000.

(b) The total amount of capital investment tax credits authorized for all certified Montana businesses may not exceed a total of \$5 million which must be authorized prior to June 30, 2005.

(3) (a) Before June 30, 2005, capital investment tax credits available under [sections 1 through 13] must be allocated to certified Montana businesses in the order that completed applications for qualification as a certified Montana business were received by the department, and the department shall certify to each certified Montana business its appropriate allocation of available capital investment tax credits.

(b) If the legislature provides additional capital investment tax credits under [sections 1 through 13] after June 30, 2005, or if capital investment tax credits become available by reversion to the department by a certified Montana business, those additional or reverted capital investment tax credits must be allocated by the department to certified Montana businesses in accordance with [sections 1 through 13] and the rules of the department.

(4) Investors in a certified Montana business are eligible for capital investment tax credits as provided for in subsection (5) within the limits imposed under [sections 1 through 13]. Funds invested in a certified Montana business may, at the discretion of the investor, be placed in an escrow account in a Montana financial institution pending qualification of the Montana business as a certified Montana business.

(5) Subject to the provisions of subsections (2) and (8), an individual, small business corporation, partnership, trust, decedent's estate, or corporate taxpayer that makes a qualified investment in a certified

Montana business is eligible for a capital investment tax credit equal to 25% of the investment, up to a maximum capital investment tax credit of \$250,000, for each certified Montana business in which the investor makes an investment. The capital investment tax credit may be taken against the tax liability imposed on the investor pursuant to Title 15, chapter 30 or 31. The capital investment tax credit for investing in a certified Montana business by a small business corporation, as defined in 15-30-1101, or a partnership may be claimed by the small business corporation shareholders or the partners.

(6) The capital investment tax credit:

(a) may be first claimed in the taxpayer's tax year that begins at least 24 months after the investor has received the certificate described in [section 10] authorizing the capital investment tax credit; and

(b) is claimable at the rate of 20% of the amount determined under subsection (5) for the first year in which the capital investment tax credit is claimed and for each of the succeeding 4 tax years.

(7) A taxpayer who is an investor in more than one certified Montana business may claim a separate capital investment tax credit for each distinct qualified Montana business in which the investor has made a qualified investment and to which the department has allocated a capital investment tax credit.

(8) (a) If the amount of the capital investment tax credit exceeds the taxpayer's tax liability for the tax year, the amount by which the capital investment tax credit exceeds the taxpayer's tax liability may be carried back or carried forward as provided in subsections (8)(b) and (8)(c).

(b) If the sum of the amount of capital investment tax credit for the current tax year plus the amount of capital investment tax credit, if any, carried forward from a previous tax year exceeds the taxpayer's tax liability for the current tax year, the excess must first be carried back as a capital investment tax credit to a maximum of the 5 immediately preceding tax years, beginning with the earliest tax year, and, if the full capital investment tax credit remains unused, carried forward as a capital investment tax credit to a maximum of the 10 succeeding tax years, beginning with the earliest tax year.

(c) The amount of unused capital investment tax credit, if any, must be used to offset the maximum amount of the taxpayer's tax liability in each of the tax years to which the capital investment tax credit was carried back or carried forward, beginning with the earliest tax year and continuing to the next succeeding tax year until the capital investment tax credit is exhausted or the time period for using the capital investment tax credit expires.

(9) A taxpayer that obtains the maximum capital investment tax credits allowed under this section may not obtain additional capital investment tax credits on the same certified Montana business through other qualified investments, whether the additional investment is made by the investor as an individual, as any type of subsidiary to the original investor, as an affiliate, or otherwise.

NEW SECTION. Section 7. Performance requirements -- penalty -- extension permissible. (1) (a)

Except as provided in subsection (2), a certified Montana business that fails to use qualified investments in the business as required to meet the definition of qualified investments is subject to a penalty.

(b) The penalty is equal to the total of the capital investment tax credits claimed by the investors investing in that certified Montana business, multiplied by a ratio, the numerator of which is the amount of the qualified investments that the certified Montana business failed to use or misused, as determined under [section 8(4)], and the denominator of which is the total amount of qualified investments in the business.

(c) In addition to the penalty, interest on the penalty accrues at the rate of 0.5% a month or portion of a month from the date the capital investment tax credits were certified as allocated to the certified Montana business.

(2) If the violation for which the penalty is imposed was not due to neglect on the part of the certified Montana business and the certified Montana business establishes reasonable cause for the violation, the department may:

(a) abate or suspend the penalty; or

(b) grant an extension of time within which the certified Montana business may remedy the violation.

(3) A certified Montana business whose securities are guaranteed by the United States small business administration pursuant to Title III of the Small Business Investment Act of 1958 may not be required to pay the penalty until all amounts due under the terms of the guarantee of the securities are paid in full.

(4) The department of revenue shall deposit all penalties received under this section to the credit of the state general fund.

NEW SECTION. Section 8. Recapture. (1) (a) If the examination conducted pursuant to [section 11] discloses that a certified Montana business has failed to use or has misused any of the qualified investments associated with the use of the capital investment tax credits as required to meet the definition of qualified investments, the department may exercise the right of recapture.

(b) If the department determines that recapture is in doubt by other means, the department may, except as provided in subsection (2), seize the assets of the certified Montana business and liquidate the assets. If the assets are liquidated, any penalty imposed under [sections 1 through 13] must be included in the claims to be paid.

(2) If a certified Montana business has any fixed or contingent obligations to the United States small business administration or its designee:

(a) the department may not exercise the authority granted in subsection (1) without the prior written consent of the United States small business administration; and

(b) the proceeds from any liquidation, including the collection of any unfunded commitments, must be applied first toward the payment of all sums that may be due the United States small business administration.

(3) The amount of the capital investment tax credits subject to recapture is determined by multiplying the total amount of capital investment tax credits claimed for qualified investments in the certified Montana business by the ratio that the unused or misused portion of 80% of the qualified investments bears to 80% of the qualified investments made in the certified Montana business.

(4) For the purposes of this section, a certified Montana business:

(a) fails to use the qualified investment if the business fails to meet the criteria established in [section 2(10)(a) or (10)(b)]; and

(b) misuses the qualified investment if the business expends more than 10% of the qualified investment on ineligible business activities in any 12-month period.

(5) The department shall use all legal means to collect the full amount of capital investment tax credits subject to recapture under this section.

NEW SECTION. Section 9. Application requirements. An entity applying to become a certified Montana business shall include in its application evidence that it has, prior to accepting an investment, disclosed or will disclose to all investors, the following:

(1) the condition that capital investment tax credits under [sections 1 through 13] are not available for investment in a Montana business until:

(a) the Montana business has been qualified as a certified Montana business; and

(b) the certified Montana business has received from the department a certificate allocating a capital investment tax credit to the certified Montana business; and

(2) the limits on capital investment tax credits that may be allocated to:

(a) the certified Montana business in which the investment may be made; and

(b) all certified Montana businesses.

NEW SECTION. Section 10. Authorizing certificate -- reporting and recordkeeping. (1) Each certified Montana business shall report to the department on a quarterly basis:

(a) the name of each investor in the certified Montana business to which the department has allocated

capital investment tax credits;

(b) the amount of each investor's investment;

(c) the amount of the capital investment tax credit allocated to each investor and the date on which each investor's investment was made; and

(d) any other information determined by the department to be necessary.

(2) (a) The department shall provide annually to each investor in a certified Montana business a certificate authorizing and specifying the amount of the capital investment tax credit allowable to the investor.

(b) The certificate or a notarized copy of the certificate must be submitted with each tax return submitted by the investor in which a capital investment tax credit is claimed under [sections 1 through 13].

(3) Each certified Montana business shall report to the department on a quarterly basis the manner in which qualified investments that the certified Montana business has received have been used in order to ensure compliance with the requirements and restrictions imposed on the certified Montana business.

NEW SECTION. Section 11. Examination. (1) At least once a year, the department shall examine the books and affairs of each certified Montana business. The examination must address the methods of operation and conduct of the business of the certified Montana business to determine if the business is abiding by the purposes of [sections 1 through 13] and if qualified investment funds received by the certified Montana business have been invested as required under [sections 1 through 13].

(2) The department may examine under oath any of the officers, directors, agents, or employees of or investors in a certified Montana business. The department may issue subpoenas and administer oaths. Refusal to obey a subpoena may at once be reported to the district court of the district in which the certified Montana business is located, and the court shall enforce obedience to the subpoena in the manner provided by law.

(3) The cost of the annual review must be paid by each certified Montana business in accordance with reasonable fees assessed by the department.

NEW SECTION. Section 12. Decertification. (1) (a) If the department determines that the seizure and sale of assets allowed under [section 8] is not required to protect the certified Montana business's investors, the department may place the business on notice that it will lose its certification as a certified Montana business within a specified period of time unless the business uses qualified investments in the business as required.

(b) Except as provided in subsection (1)(c), the department shall automatically decertify a certified Montana business that is assessed and pays a penalty under [section 7].

(c) If the department, under [section 7], abates entirely or suspends a penalty or grants an extension of time, the department may also delay or suspend decertification.

(2) If acting in good faith, the department and its employees and agents may not be held civilly or criminally liable or liable upon any official bond for action taken under [section 8] or this section or for any failure to act under [section 8] or this section.

(3) A certified Montana business may apply to the department for decertification.

(4) The department may decertify any certified Montana business that is not in compliance with [sections 1 through 13].

(5) The department shall decertify a certified Montana business after the certified Montana business has successfully complied with the requirements of [sections 1 through 13] for at least 5 years after the date on which the business was qualified by the department as a certified Montana business.

(6) Decertification of a qualified Montana business under subsection (5) does not affect the ability of an investor that has been allocated a capital investment tax credit from claiming the credit at any time during the period within which the credit is claimable, including the carryback and carryforward periods.

NEW SECTION. Section 13. Conflict of interest. A certified Montana business may not, for the purposes of seeking a capital investment tax credit under [sections 1 through 13] against its own tax liability, invest in itself.

NEW SECTION. Section 14. Effective date -- retroactive applicability. [This act] is effective July 1, 2003, and applies retroactively, within the meaning of 1-2-109, to tax years beginning after December 31, 2002.

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