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STATE OF RHODE ISLAND

IN GENERAL ASSEMBLY

JANUARY SESSION, A.D. 2014

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A N A C T

RELATING TO TAXATION - TAX INCENTIVES FOR CAPITAL INVESTMENT IN
SMALL BUSINESSES

Introduced By: Representatives Finn, Kennedy, Keable, Hearn, and Marshall

Date Introduced: March 04, 2014

Referred To: House Finance

It is enacted by the General Assembly as follows:

1 SECTION 1. Sections 44-43-1, 44-43-2, 44-43-3, 44-43-5 of the General Laws in
2 Chapter 44-43 entitled "Tax Incentives for Capital Investment in Small Businesses" are hereby
3 amended to read as follows:

4 **44-43-1. Definitions.** -- For the purpose of this chapter:

5 (1) "Average annual gross revenue" means the average of the amounts received or
6 accrued by a qualifying business entity determined on an annualized basis from the sale of goods
7 or services prior to diminution by the cost of those sales or services. The determination is limited
8 to amounts, if any, received or accrued during the four (4) taxable years of the business entity, or
9 a lesser period as may be applicable, immediately preceding the taxable year during which the
10 entity applied to the department for certification as a qualifying business entity.

11 (2) "Certified venture capital partnership" means any partnership formed under the laws
12 of Rhode Island that:

13 (i) Has at least three (3) partners each of whom has contributed at least five thousand
14 dollars (\$5,000) and who have contributed in the aggregate at least two hundred fifty thousand
15 dollars (\$250,000) to the partnership;

16 (ii) Employs a professional manager who is an individual with prior experience managing
17 venture capital funds;

18 (iii) Is organized and operated to invest at least ninety percent (90%) of the amounts

1 contributed to its capital in qualifying activities and is registered or exempt from registration
2 under the securities laws of Rhode Island;

3 ~~(iv) Has bonding of its employees to fully cover all funds received from partners;~~

4 ~~(iv)~~(iv) Has filed with the department information as may be requested describing its
5 organization, operation, and programs and has received certification and annual recertification
6 from the department pursuant to rules and regulations promulgated by the department, that its
7 organization, operation, and proposed programs comply with the requirements of this chapter;
8 and

9 ~~(iv)~~(v) Has not violated the requirements prescribed in this chapter, or the conditions and
10 requirements imposed by the department.

11 (3) "Department" means the Rhode Island economic development corporation.

12 (4) "Entrepreneur" means any individual in the employ on a full-time basis of a
13 qualifying business entity who owns an interest in the entity equal to at least five percent (5%) in
14 value of the entity.

15 (5) "Qualifying activities" means to provide capital:

16 (i) To invest in one or more qualifying business entities whose principal office and the
17 majority of whose assets are located in Rhode Island;

18 (ii) To invest a portion of its funds, as stated in this section, in one or more qualifying
19 business entities whose principal office is located outside of Rhode Island and who have entered
20 into binding commitments to establish, expand, or increase its operations at a regular place of
21 business in Rhode Island; or

22 (iii) To invest a portion of its funds, as stated in this section, in research and
23 experimental expenditures (as defined in 26 U.S.C. section 174) conducted in Rhode Island to
24 assist those qualifying business entities in which the partnership has or would be able to invest. A
25 certified venture capital partnership commencing with its first year of operation, or after there has
26 been a forty percent (40%) change in ownership or the admission of new partners whose
27 contributions have increased the capital of the partnership by at least sixty-five percent (65%),
28 may invest in the aggregate up to the following total portion of its investments made during each
29 year in the types of investments described in subdivisions (6)(ii) and (6)(iii) of this section.

30	<u>Year</u>	<u>Portion</u>
31	1	50%
32	2	40%
33	3	30%
34	4	30%

1	5	30%
2	6 and subsequent years	20%

3 (6) "Qualifying business entity" means any corporation, partnership or other business
 4 entity that meets all of the following criteria and the predecessors and successors of any
 5 corporation, partnership or other business entity:

6 (i) Whose average annual gross revenue is less than two million five hundred thousand
 7 dollars (\$2,500,000);

8 (ii) Which has been in business for less than four (4) years; and

9 (iii) Which will expend an amount which is not less than the amounts allowed as a
 10 deduction under section 44-43-2 to establish, expand or increase its operations at a regular place
 11 of business in Rhode Island or to purchase the interest of one or more prior owners of the entity if
 12 the entity has entered into binding commitments to expend an amount not less than the amount
 13 paid to establish, expand or increase the entity's operations at a regular place of business in Rhode
 14 Island; and

15 (iv) Has received certification and annual recertification from the department, pursuant to
 16 rules and regulations promulgated by the department, that the preceding requirements have been
 17 satisfied.

18 (7) "Qualifying investment" means that portion, determined based on a taxpayer's interest
 19 in a certified venture capital partnership under 26 U.S.C. section 702(a)(8), of the taxpayer's
 20 investment in the partnership that is invested by the partnership in qualifying activities during the
 21 taxpayer's taxable year.

22 (8) "Certified Angel Investor" means:

23 (i) A bank, insurance company, registered investment company, business development
 24 company, or small business investment company;

25 (ii) An employee benefit plan, within the meaning of the employee retirement income
 26 security act, if a bank, insurance company, or registered investment advisor makes the investment
 27 decisions, or if the plan has total assets in excess of five million dollars (\$5,000,000);

28 (iii) A charitable organization, corporation, or partnership with assets exceeding five
 29 million dollars (\$5,000,000);

30 (iv) A director, executive officer, or general partner of the company selling the securities;

31 (v) A business in which all the equity owners are accredited investors;

32 (vi) A natural person who has net worth, or joint net worth with the person's spouse, that
 33 exceeds one million dollars (\$1,000,000) at the time of the purchase, excluding the value of the
 34 primary residence of such person;

1 (vii) A natural person with income exceeding two hundred thousand dollars (\$200,000) in
2 each of the two (2) most recent years or joint income with a spouse exceeding three hundred
3 thousand dollars (\$300,000) for those years and a reasonable expectation of the same income
4 level in the current year; or

5 (viii) A trust with assets in excess of five million dollars (\$5,000,000), not formed to
6 acquire the securities offered, whose purposes a sophisticated person makes.

7 (9) "Venture Capital Fund" means any private fund that:

8 (i) Represents to investors and potential investors that it pursues a venture capital
9 strategy;

10 (ii) Immediately after the acquisition, other than qualifying investments or short-term
11 holdings, holds no more than twenty percent (20%) of the amount of the fund's aggregate capital
12 contributions and uncalled committed capital assets (other than short-term holdings) that are not
13 qualifying investments, valued at cost or fair value, consistently applied by the fund;

14 (iii) Does not borrow, issue debt obligations, provide guarantees or otherwise incur
15 leverage, in excess of fifteen percent (15%) of the private fund's aggregate capital contributions
16 and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is
17 for a non-renewable term of no longer than one hundred twenty (120) calendar days, except that
18 any guarantee by the private fund of a qualifying portfolio company's obligations up to the
19 amount of the value of the private fund's investment in the qualifying portfolio company is not
20 subject to the one hundred twenty (120) day calendar limit;

21 (iv) Only issues securities the terms of which do not provide a holder with any right,
22 except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such
23 securities but may entitle holders to receive distributions made to all holders pro rata; and

24 (v) Is not registered under section 8 of the Investment Company Act to 1940 (15 U.S.C.
25 80a-8), and has not elected to be treated as a business development company pursuant to section
26 54 of that act (15 U.S.C. 80a-53).

27 **44-43-2. Deduction or modification. --** (a) In the year in which a taxpayer or certified
28 angel investor as defined in § 44-43-1 first makes a qualifying investment in a certified venture
29 capital partnership or the year in which an entrepreneur first makes an investment in a qualifying
30 entity, the taxpayer, certified angel investor, or the entrepreneur shall be allowed:

31 (1) A deduction for purposes of computing net income or net worth in accordance with
32 chapter 11 of this title; or

33 (2) A deduction from gross earnings for purposes of computing the public service
34 corporation tax in accordance with chapter 13 of this title; or

1 (3) A deduction for the purposes of computing net income in accordance with chapter 14
2 of this title; or

3 (4) A deduction for the purposes of computing gross premiums in accordance with
4 chapter 17 of this title; or

5 (5) A modification reducing federal adjusted gross income in accordance with chapter 30
6 of this title.

7 (b) The deduction or modification shall be in an amount equal to the taxpayer's or
8 certified angel investors as defined in § 44-43-1 qualifying investment in a certified venture
9 capital partnership or an entrepreneur's investment in a qualifying business entity and shall be
10 measured at the year end of the certified venture capital partnership, the year end of the
11 qualifying business entity, or the year end of the investing taxpayer, whichever comes first.

12 **44-43-3. Wage credit.** -- (a) There shall be allocated among the entrepreneurs of a
13 qualifying business entity (based on the ratio of each entrepreneur's interest in the entity to the
14 total interest held by all entrepreneurs) with respect to each entity on an annual basis commencing
15 with the calendar year in which the entity first qualified as a qualifying business entity a credit
16 against the tax imposed by chapter 30 of this title. The credit shall be equal to three percent (3%)
17 of the wages (as defined in 26 U.S.C. section 3121(a)) in excess of ~~fifty thousand dollars~~
18 ~~(\$50,000)~~ one hundred thousand dollars (\$100,000) paid during each calendar year to employees
19 of the entity; provided, that there shall be excluded from the amount on which the credit is based
20 any wages:

21 (1) Paid to any owner of the entity;

22 (2) Paid more than five (5) years after the entity commenced business or five (5) years
23 after the purchase of the business entity by new owners, whichever occurs later; or

24 (3) Paid to employees who are not principally employed in Rhode Island and whose
25 wages are not subject to withholding pursuant to chapter 30 of this title.

26 (b) The credit authorized by this section shall cease in the taxable year next following
27 after the taxable year in which the average annual gross revenue of the business entity equals or
28 exceeds ~~one million five hundred thousand dollars (\$1,500,000)~~ three million dollars
29 (\$3,000,000).

30 **44-43-5. Exemption.** -- To the extent that a long-term capital gain was included in the
31 calculations of taxes imposed by chapters 11, 13, 14 or 30 of this title, that long-term capital gain
32 shall be excluded. The long-term capital gain is the long-term capital gain as defined in 26 U.S.C.
33 section 1222(3) which is:

34 (1) Recognized by a partner in a certified venture capital partnership from the sale or

1 exchange of an interest in the partnership; or

2 (2) A partner's distributive share (in a certified venture capital partnership) of any long-
3 term capital gain recognized by the partnership from the sale or exchange of an interest in any
4 entity which at the time the interest was acquired was a qualifying business entity; or

5 (3) The long-term capital gain recognized by an entrepreneur [or certified angel investor](#)
6 [as defined in § 44-43-1](#) from the sale or exchange of an interest in an entity, which at the time the
7 interest was acquired was a qualifying business entity.

8 SECTION 2. This act shall take effect upon passage.

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EXPLANATION
BY THE LEGISLATIVE COUNCIL
OF

A N A C T

RELATING TO TAXATION - TAX INCENTIVES FOR CAPITAL INVESTMENT IN
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1 This act would broaden the number and composition of investors eligible for tax
2 deductions under this chapter by adding a category called "certified angel investors", which
3 would include certain individuals, employee benefit plans, banks, insurance companies, trusts,
4 and investment companies who make capital investments in small business, and adds "venture
5 capital funds" which are private funds with various conditions on acquisition and borrowing and
6 issuing of securities.

7 This act would take effect upon passage.

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