

SESSION OF 2018

**SECOND CONFERENCE COMMITTEE REPORT BRIEF  
SENATE BILL NO. 296**

As Agreed to May 4, 2018

**Brief\***

SB 296 would establish the *Ad Astra* Rural Jobs Act and make revisions to the High Performance Incentive Program (HPIP) and the Sales Tax and Revenue (STAR) Bond Financing Act.

***Ad Astra Rural Jobs Act***

The *Ad Astra* Rural Jobs Act would authorize nonrefundable tax credits applicable to income, premiums, privilege, or insurance 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. Twenty percent of the tax credit could be claimed annually over a five-year period, starting after the second anniversary of the “closing date,” as that term would be defined by the bill. The amount of tax credits claimed in any one fiscal year would not exceed \$10.0 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 seventh year following the effective date of the bill. Qualified equity investments made prior to the sunset would not prevent the claiming of credits.

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\*Conference committee report briefs are prepared by the Legislative Research Department and do not express legislative intent. No summary is prepared when the report is an agreement to disagree. Conference committee report briefs may be accessed on the Internet at <http://www.kslegislature.org/kldr>

### *Approval Process for Investment Companies*

Starting October 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 being either a federally licensed rural business investment company or a small business investment company, demonstrating the applicant or its affiliates have invested a minimum amount of \$100.0 million in non-publicly traded companies in counties with a population of less than 50,000;
- An estimate of the number of jobs to be created or retained as a result of the applicant’s funding;
- A business plan for the applicant’s funding that would include:
  - A ten-year 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 (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 \$83.3 million in growth capital and \$50.0 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 specific credential 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 60.0 percent of the capital sought under the applicant's business plan; or
  - Equity investments do not equal a minimum of 10.0 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 and credit-eligible capital contributions.

*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 15 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, 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 100.0 percent of its growth capital in funding within two years of the closing date;
- Fails to maintain the investment for six 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. An approved investment company would not be required to reinvest returned capital after the fifth anniversary of the closing date. The amount of funding necessary to maintain an investment in any one rural business concern would not exceed \$6.5 million or 20.0 percent of the approved investment company's total growth capital, whichever would be greater;
- Makes a distribution or payment that results in the approved investment fund having less than 100.0 percent of its growth capital invested in fundings or available for investments in fundings and held as cash or marketable securities;
- 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 its 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 it takes to correct a violation, the investment company would be charged \$5,000 per day.

After the sixth anniversary 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 60.0 percent of the amount projected in the business plan, the State would receive 30.0 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
- Greater than 60.0 percent but less than 100.0 percent of the amount projected in the business plan, the State would receive 15.0 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.

When determining the number of jobs created or retained by a rural business, the Secretary would reduce the job projections contained in the business plan, on a *pro rata* basis, based on the actual amount of growth capital received by the approval investment fund to the total amount of growth capital for which the approved investment fund applied.

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 substantive definitions for the following 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 funding 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 in the amount

approved by the Secretary. At least 60.0 percent of growth capital would be comprised of credit-eligible capital contributions. At least 10.0 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 who is a business that has not participated in HPIP or the Promoting Employment Across Kansas (PEAK) Program in the past five years and which is not a publicly traded business;
- “Principal business operations” would mean the location where at least 60.0 percent of a company’s employees work or where employees are paid at least 60.0 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 250 employees or had an average federal adjusted gross income of less than \$10.0 million in the three preceding tax years; and
  - Engages in industries related to manufacturing, plant sciences, technology, farming, forestry, biotechnology, fisheries, biofuels, transportation, health care, warehousing, the supply of inputs for the agriculture and food industries, food production, the feed industry, 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.

### ***HPIP Tax Credits***

The bill would extend 25.0 percent of unused HPIP tax credits beyond the current carryforward limit, from 16 years to 25 years, for those taxpayers who initially claimed an HPIP credit prior to January 1, 2018. In any tax year after the 16<sup>th</sup> year, the amount of tax credits used by a taxpayer would be limited to 10.0 percent of the reduced amount. Taxpayers would be required annually to certify under oath to the Secretary that they continue to meet HPIP requirements. The bill would not revive HPIP tax credits that expired before January 1, 2018.

### **STAR Bond Financing Act**

The bill would cap the State's contribution to STAR Bond project districts that are submitted on and after January 1, 2019, to the Secretary for approval. The State would contribute an amount that would be 85.0 percent of the state sales tax rate. The bill would provide for the same distribution in instances where an existing Kansas business relocates into or becomes a part of a STAR Bond project district, as would be certified by the secretaries of Revenue and Commerce. For communities that submitted their STAR Bond project district plans for approval under current law, the Secretary has discretionary authority to pledge all or a portion of increased state sales and use tax revenues to finance STAR Bonds.

### **Conference Committee Action**

On May 4, 2018, the second Conference Committee agreed to delete the contents of SB 296, as amended by the House Committee on Judiciary, which would have allowed evidence of failure to use a safety belt to be admissible in certain actions, and inserted the contents of HB 2168, as amended by the House Committee of the Whole (*Ad Astra* Rural Jobs Act), and SB 430, as amended by the Senate Committee on Commerce (HPIP). The second Conference Committee also included provisions pertaining to STAR Bonds.

With regard to the *Ad Astra* Rural Jobs Act, the second Conference Committee agreed to amend the language further to:

- Decrease the cap on growth capital, from \$166.7 million to \$83.3 million;
- Decrease the amount of credit-eligible contributions, from \$100.0 million to \$50.0 million;

- Decrease the cap placed on the amount of tax credits that may be claimed in any one fiscal year, from \$20.0 million to \$10.0 million;
- Allow the tax credit to be claimed against certain insurance taxes authorized by KSA 40-253;
- Clarify and revise the means by which an approved investment company may maintain an investment;
- Authorize the Secretary to begin accepting applications from investment companies on October 1, 2018, instead of January 1, 2018;
- Reduce the number of days in which the Department may designate a business a “rural business concern,” from 30 days to 15 days;
- Authorize fees to be charged daily by the Secretary for violations, rather than 90 days after violations have been found;
- Clarify when clawback provisions would take effect; and
- Revise the following definitions:
  - “Approved investment company” by omitting reference to rural business investments;
  - “Growth capital” by omitting inclusion of government grants, guaranteed debenture funds, or other public funds as a form of other-case investment equivalents;
  - “Operating company” by omitting reference to a person doing business, or seeking to do business, in Kansas and inserting language referencing businesses that have not participated in HPIP or PEAK in the past five years; and
  - “Rural business concern” by:

- Reducing the number of employees from 500 to 250;
- Reducing federally adjusted gross income from \$15.0 million to \$10.0 million; and
- Adding additional industries that a rural business concern may engage in.

With regard to the HPIP, the second Conference Committee agreed to amend the language further to limit the amount of unused HPIP credits that would be extended beyond the 16<sup>th</sup> year, from 50.0 percent to 25.0 percent.

With regard to STAR Bonds Financing Act, the second Conference Committee agreed to place a cap on state contributions to future development districts.

## **Background**

### ***HB 2168 (Ad Astra Rural Jobs Act)***

The bill was introduced by Representatives Waymaster, Claeys, Concannon, Davis, and Hoffman during the 2017 Legislative Session. 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 complement 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, 2017, the House Committee amended the bill to:

- Revise the definition for “growth capital,” requiring 60.0 percent instead of 40.0 percent to be composed of credit-eligible capital contributions. [*Note:* The Conference Committee retained this amendment.];
- Limit the total amounts of growth capital and credit-eligible capital contributions that may be approved by the Secretary to \$166,666,666 and \$100.0 million, respectively. [*Note:* The Conference Committee revised this amendment.]; 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. [*Note:* The Conference Committee revised this amendment.]

On February 23, 2017, the bill was referred from the House to the House Committee on Appropriations. Later that day, the bill was rereferred to the House Committee on Taxation. On March 8, 2017, the bill was rereferred to the House Committee on Commerce, Labor and Economic Development. On March 9, 2017, 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, 2017, 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. [*Note:* The Conference Committee retained this amendment.]

### ***SB 430 (HPIP)***

HPIP provides persons with a 10.0 percent nonrefundable income tax credit for eligible capital investments that exceed either \$50,000 in non-metropolitan

counties or \$1.0 million in the five metropolitan counties of Douglas, Johnson, Sedgwick, Shawnee, or Wyandotte. In 2011, the Legislature passed legislation that provided for an extension to use HPIP credits from 10 years to 16 years.

The bill was introduced by the Senate Committee on Ways and Means during the 2018 Legislative Session. The Senate Committee on Commerce did not receive testimony since the contents of the bill were identical to the provisions of SB 334, as amended by the Senate Committee. The history of SB 334 may be found in the supplemental note for that bill.

The Senate Committee amended the bill on March 20, 2018, to:

- Limit the amount of unused HPIP credits that would be extended beyond the 16<sup>th</sup> year, from 75.0 percent to 50.0 percent. [*Note:* The Conference Committee revised this amendment.];
- Cap the annual amount of credits that could be claimed after the 16<sup>th</sup> year to 10.0 percent of the reduced amount. [*Note:* The Conference Committee retained this amendment.]; and
- Clarify the extension beyond the 16<sup>th</sup> year would be for taxpayers who initially claimed a credit. [*Note:* The Conference Committee retained this amendment.]

### ***Fiscal Information***

According to the fiscal notes prepared by the Division of the Budget on HB 2168, as introduced, and SB 430, as introduced, and including additional revenue analysis provided by the Kansas Department of Revenue (KDOR), the bill is estimated to have the following impact on revenues and expenditures.

**State General Fund (SGF) Revenue Impact**

(Dollars in Millions)

| <b>Program</b>          | <b>FY 2019</b> | <b>FY 2020</b> | <b>FY 2021</b> | <b>FY 2022</b> |
|-------------------------|----------------|----------------|----------------|----------------|
| Ad Astra Rural Jobs Act | 0.0            | 0.0            | (10.0)         | (10.0)         |
| HPIP                    | (3.8)          | (3.8)          | (3.8)          | (3.8)          |
| STAR Bonds*             | 0.0            | 0.0            | 0.0            | 0.0            |
| <b>Total</b>            | <b>(3.8)</b>   | <b>(3.8)</b>   | <b>(13.8)</b>  | <b>(13.8)</b>  |

\*KDOR notes the provisions of the bill pertaining to STAR Bonds could have a positive effect on revenues, assuming new sales tax revenue would be generated in future STAR Bond districts approved by the Department of Commerce.

With regard to the *Ad Astra Rural Jobs Act*, the Department of Commerce (Department) indicates the bill would require \$375,000 and \$325,000 from the SGF for FY 2019 and FY 2020, respectively. The Department estimates it would require 3.0 new FTE positions, starting in FY 2019, to administer provisions of the tax credit program. KDOR indicates the bill would require \$237,333 from the SGF and 2.0 new FTE positions in FY 2019 to implement provisions of the bill.

With regard to HPIP, the Department estimates the additional costs of certifying HPIP companies beyond the 16<sup>th</sup> year would be negligible and could be absorbed within existing resources. KDOR estimates it would require \$29,100 from the SGF in FY 2019 to implement the bill, assuming existing staff is utilized to modify the programming of the automated tax system.

Any fiscal effect associated with the bill is not reflected in *The FY 2019 Governor's Budget Report*.

economic development; tax credit; HPIP; STAR Bonds

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