

**Kansas Department of Commerce
Proponent Testimony on HB 2045
David Soffer, Legislative & Policy Director
Prepared for House Commerce, Labor and Economic Development
January 13, 2021, 1:30 p.m.**

The Department of Commerce is proposing a renewal of the Angel Investors program with modifications. The modifications are focused on adjusting the credits that can be given to investors, technical adjustments and increasing appropriations based on the increased demand expected in the years ahead.

The Angel Investor Tax Credit is one of the only incentives we currently offer to help stimulate our innovative entrepreneurs to invest and build in Kansas. In the global economy, it is these high-risk companies that are producing the most growth, when successful. As part of our statewide analysis we will be releasing next week, the growing theme has been how little our State invests in the innovative/tech sectors. If we are to truly align our State with where the global economy is headed, we must find ways to invest in more opportunities similar to Angels and making it known that Kansas is a great place for forward thinking entrepreneurs.

The purpose of the Kansas Angel Investors Tax Credit Act is to facilitate:

- The availability of equity investment in businesses in the early stages of commercial development.
- Assist in the creation and expansion of Kansas businesses, which are job and wealth creating enterprises.

Under the Kansas Angel Investor Tax Act, an accredited investor is allowed a 50% tax credit on their cash investment of up to \$50,000, per certified Kansas business per year. Additionally, for each tax year, an angel investor shall not be entitled to claim tax credits under this Act of more than \$250,000. An Investor must register on the program's website before being eligible to receive the credit.

A person who serves as an executive, officer, employee, vendor or independent contractor of the business in which an otherwise qualified cash investment is made is not an angel investor and such person shall not qualify for the issuance of tax credits for such investment.

Any general partnership, limited partnership, corporation that has in effect a valid election to be taxed as an S corporation under the United States internal revenue code, or a limited liability company that has elected to be taxed as a partnership under the United States internal revenue

code and (B) that was established and is operated for the sole purpose of making investments in other entities, may also invest and receive credits.

Companies must meet the following criteria to be certified as a Qualified Kansas Business:

1. The business has a reasonable chance of success and potential to create measurable employment within Kansas.
2. In the most recent tax year of the business, annual gross revenue was less than \$5,000,000.
3. Businesses that are not bioscience businesses must have been in operation for less than 5 years; bioscience businesses must have been in operation for less than 10 years.
4. The business has an innovative and proprietary technology, product, or service.
5. The existing owners of the business have made a substantial financial and time commitment to the business.
6. The securities to be issued and purchased are qualified securities.
7. The company agrees to adequate reporting of business information to KDC.
8. The ability of investors in the business to receive tax credits for cash investments in qualified securities of the business is beneficial because funding otherwise available for the business is not available on commercially reasonable terms.
9. Signed Qualified Company Agreement with the KDC.

Information that will be required when submitting the application:

- Proof you are a Kansas company: Articles certified by the Secretary of State
- Proof you are headquartered in Kansas
- Complete business plan and bylaws
- Executive summary
- Target market
- Statement on the innovativeness of your product, service or technology: Why are you different?
- Statement of potential Kansas economic impact: How many jobs and the type? How many locations? Where will you be located? The impact your presence will have on the community.
- Description of the securities offered (sample of the security agreement that will be offered in conjunction with the tax credits)
- Current financial statement
- Projected financial statement
- Your NAICS Code
- The amount of tax credits you are wanting and what their use will be
- List of all owners with % of ownership and amount invested for ownership
- Current management staff with statement of background
- Current and projected employee numbers and their work location (paid employees KCNS-100)
- Current board of directors and/ or advisors with statement of background
- If you have expected investors who are they?

Once a business submits an application, a three person team is tasked with evaluating the application to make sure that it meets the statute requirements, and confirm it is an innovative

company (for example last year a consulting company applied and the team turned down the application).

Currently the Department is allotted \$6,000,000 in tax credits annually to distribute to companies. Generally, the company is allotted \$150,000 in initial credits if approved and may return for additional credits if they succeed in leveraging all their initial allocation.

If an investor would like to sell or transfer his credit, the investor may if the investor has not had a tax liability in the last three years.

Modifications to the Angel Investors Program

1. 5-year extension of the program
2. Grow appropriations to \$8 Million by phasing in \$500,000 increments starting in FY 23
3. Amending the standard for convertible notes
 - This is a technical term in the statute where it states a convertible note showing at least a 7-year period, whereas convertible notes tend to have a 18-24 month period and is creating issues in getting companies approved, since 7 year convertible notes do not exist.
4. Change *Equal* to 50% to *Up* to 50%
 - Kansas is second in the nation in providing a 50% credit of the investment up to \$50,000, whereas most states provide a lower percentage. A fair proposal was changing the language from equal to up to and allow the market to determine the value of an investment.
5. Allow up to \$100,000 in credits received from a single business by the investor
 - Currently an investor may receive \$50,000 in credits. This limit was set over ten years ago
6. Allow for up to \$350,000 credits per investor per year
 - Currently an investor may receive \$250,000 in credits. This limit was set over ten years ago
7. Eliminate reference to Kansas Venture Capital Inc. in statute
 - Program has not existed for quite a few years.
8. Changing the standard for credit transfers based on tax clearance and not if credit holder had a liability at any point in last three years
 - This change was made with the consultation of the Department of Revenue. KDOR was not aware why it was written the way it was, but too many credit holders have issues transferring or selling their credits based off a three-year liability that doesn't account for current money owed to the State.
9. Claw back for tech companies down to 5 years

- High growth tech companies are frequently acquired for their innovation and market disruption capabilities. These acquisition events, a success for Kansas, the founders, and the investors, often occur before 10 years. Reducing the claw back to 5 years puts Kansas in line with other states while easing the regulatory burden on the company. Whereas life sciences are more complicated because of items such as FDA approval, the 10-year time period still makes sense.

We need to encourage the next Garmin, the next EyeVerify, the next Rx Savings to launch, grow and flourish in our State. The Angels program is a powerful way to do just that.

I want to thank the committee for the opportunity to testify on extending this important program. We urge the committee to pass HB 2045 and send a message to our entrepreneurs that Kansas values innovation and seed investment to turn those ideas into reality.