Just the Facts:

Kentucky Investment Fund Act (KIFA)

June 2021

The purpose of the Kentucky Investment Fund Act (KIFA) is to encourage capital investment in the Commonwealth of Kentucky, to encourage the establishment of small businesses in Kentucky, to provide additional jobs, and to encourage the development of new products and technologies in the state through capital investments. After credits are allocated to a fund, the credits are proportionately granted to the fund's investors upon completion of qualified investments. The Commonwealth, through the Kentucky Economic Development Finance Authority (KEDFA), allocates the credits to investment funds. Carefully review KRS 154.20-250 to 154.20-284 for a complete description of KIFA.

KIFA offers a nonrefundable tax credit not to exceed the following percentages of the investor's proportional ownership share of all qualified investments made by the investor's investment fund and verified by KEDFA:

- Up to 40% for investment funds approved for incentives prior to January 1, 2022
- Up to 25% for investment funds approved for incentives on or after January 1, 2022

Fund and Investment Requirements

- Minimum fund size: $500,000
  - » $500,000 in committed cash contributions to the fund must be made prior to any allocation of credits.
  - » A certified investment fund must have no less than four (4) unaffiliated investors.
  - » No investor or investment fund manager, including closely related family members, may have a capital interest in more than 40 percent of the investment fund's total capitalization. Closely related family member means any of the following in relation to the investor, the investor's spouse, the fund manager, or the fund manager's spouse; parents or grandparents; children or their spouses; or siblings or their spouses.
- "Qualified investments" eligible for this tax credit are equity interest (such as general or limited partnership interest, common or preferred stock with or without voting rights and without regard to seniority position) or near-equity (such as SAFE agreements or convertible debt instruments, or both, with warrants, rights or other means of equity conversion attached) cash investments of at least $10,000 in Kentucky-based small businesses that meet the following criteria at the time an investment is made:
  - » More than 50 percent of the company's assets, operations and employees are located in Kentucky; and
  - » The company's net worth is $5 million or less (or $10 million, if it is a knowledge-based business) or its net income in each of the prior two years is $3 million or less; and
  - » The company has no more than 100 employees.
- Each qualified investment must be in a business that is actively and principally engaged in a "qualified activity" within Kentucky or will be actively and principally engaged in a "qualified activity" within Kentucky after the receipt of a qualified investment.

- “Qualified activity” means a knowledge-based activity including bioscience, environmental and energy technology, health and human development, information technology and communications, materials science and advanced manufacturing, or other technological advances if approved by the executive director of the Office of Entrepreneurship and Small Business Innovation. A “qualified activity” does not include any activity principally engaged in by financial institutions, commercial development companies, credit companies, financial or investment advisors, brokerage or financial firms, other investment funds or investment managers, charitable and religious institutions, oil and gas exploration companies, insurance companies, residential housing developers, retail establishments, or any activity determined to be against the public interest, against the purposes of KIFA, or in violation of any law.

- Any investment made by a fund in a non-qualified small business shall not be eligible for the tax credits.

- The total amount of tax credits available to any single investment fund shall not exceed, in aggregate, $8,000,000 for all investors and all taxable years. In any calendar year beginning on or after January 1, 2022, the total amount of tax credits available to any single investment fund shall not exceed $1,000,000.
    - Total qualified investments made by an investment fund in any single business shall not exceed 30 percent of the committed cash contributions to the investment fund.
    - The fund’s stated purpose must be to primarily encourage and assist in the creation, development or expansion of small businesses located in Kentucky.

Additional Program Information

- Fund managers find the investors and make all investment decisions.
- No qualified investment shall be made in a small business that, prior to the investment being made, (i) is owned, in whole or in an amount greater than 20 percent, by any investor, officer, director, partner, member, manager, trustee or employee of the investment fund or the investment fund manager, or (ii) employs on a full-time or part-time basis an investor in the investment fund.
- An investment fund manager and its affiliates may operate no more than three (3) separate investment funds pursuant to separate applications submitted to and approved by KEDFA.
- Investors may be any persons or legal entities through which business is conducted that is subject to state tax liability, including financial institutions and insurance companies.
- A non-profit entity may transfer, for some or no consideration, any or all of the credits it receives under KIFA. (KEDFA and the Department of Revenue must be notified of any transfer within 30 days of the transfer.)
- The tax credit amount that may be claimed by an investor in any tax year shall not exceed fifty percent (50 percent) of the initial aggregate credit amount approved by KEDFA for the investment fund which would be proportionally available to the investor. The tax credit can be used to offset Kentucky tax liabilities. An investor may first claim its credit in the year following the year in which the credit is granted. No investor can take more than 50 percent of the credit in any one tax year. An investor may carry-forward unused credits for up to fifteen years.
- An investment fund shall lose all unused credits that are available to its investors if the investment fund does not make a qualified investment within one year of the date of its Investment Agreement with KEDFA or within any one-year period thereafter through the end of its term of the agreement.

- Investors with any conviction for violating Kentucky's tax laws within the past 10 years are ineligible to receive credits under KIFA.
- Fund managers are required to provide annual financial statements and reports of the investment fund to KEDFA within 90 days after the end of the investment fund's fiscal year.

Credit Caps

A maximum of $3,000,000 in tax credits can be allocated to investment funds in each calendar year.

The Process

- Fund manager completes and submits the KIFA application to Cabinet staff.
- The total amount of incentives to be recommended for approval of a fund is negotiated with the Cabinet as well as any fund-specific terms that may apply.
- The fund is presented to KEDFA for approval and, if approved, KEDFA enters into an incentive agreement with the fund that sets forth the terms and conditions.
- The fund completes its required annual qualified investments in Kentucky small businesses engaged in a qualified activity. Within 80 days following the making of a qualified investment, the investment fund manager files disclosure forms with KEDFA.
- The fund submits annual reporting requirements throughout the term of its incentive agreement to remain compliant.

Fees

A non-refundable application fee of $1,000 is payable upon submission of the KIFA application. Prior to signing the incentive agreement, the company will be required to pay an administrative fee equal to one-tenth of one percent (0.1%) of the KIFA total tax credits approved and authorized in the incentive agreement. Additionally, an annual fee equal to one-tenth of one percent (0.1%) of the fund's allocated tax credits shall be paid to KEDFA. The annual fee is due on or before the anniversary date of the fund's approval by KEDFA each year throughout the term of the agreement. The company will also pay all legal fees, including expenses of counsel to KEDFA, necessary for the preparation of the incentive agreement.

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