

CORPORATE AND SECURITIES LAW

Alert

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

**Recent Actions by the Federal and Tennessee State Governments
Affect Private Capital Managers**

July 10, 2009

The Obama Administration and the Tennessee legislature have recently taken certain actions that may be noteworthy for venture capital investors and other managers of private pools of capital.

Obama Administration Releases Financial Regulatory Reform Proposal

On June 17, 2009 the Obama Administration set forth its plan for reforming the financial regulatory regime in the United States. The plan as proposed contains a number of potentially significant changes to the current regulatory framework. Specifically with respect to regulation of private pools of capital – including venture capital funds, private equity funds and hedge funds – the new framework would require that all advisers to these private funds whose assets under management exceed some “modest” threshold to register as investment advisers under the Investment Advisers Act of 1940. As registered advisers, these entities would be required to report information on the funds they manage and would be subject to regular examination by the SEC. In addition, all private investment funds managed by registered advisers would be subject to recordkeeping requirements, requirements with respect to disclosure to investors, creditors and counterparties, and regulatory reporting requirements (including the amount of assets under management, borrowings and other data necessary to assess whether any fund poses a threat to financial stability).¹

While the scope of the proposed regulations remains uncertain, pending legislation may provide some guidance. In January, Senators Charles Grassley (R-Iowa) and Carl Levin (D-Michigan) introduced the Hedge Fund Transparency Act of 2009, which would require registration for those

¹ Although the Private Equity Council, which represents 12 of the largest buyout firms in the U.S., has issued a statement in support of the administration’s proposed plan for new financial regulation, the National Venture Capital Association (the “NVCA”), the trade association representing the U.S. venture capital industry, released a statement that it

“understands the need for these important reforms for investment managers that could pose significant systemic risk to the stability of our financial system. However, [the NVCA] strongly assert[s] that the venture capital industry does not pose such risks and therefore should not be swept into regulation intended for other investment vehicles.”

advisers with \$50 million or more under management. On June 16, 2009 Senator Jack Reed (D-Rhode Island) introduced a bill that sets the threshold for registration at \$30 million.

Statute Gives Tennessee-based Venture Capital Firms an Opportunity to Participate in Tax Credit Program

Tennessee recently enacted a statute allocating up to \$120 million in future tax credits to up to six qualifying Tennessee-based venture capital firms, known as TNInvestcos, to enable these firms to raise capital from insurance companies to invest in certain Tennessee small businesses. The Tennessee Small Business Investment Company Credit Act provides that those venture capital funds will each be awarded \$20 million in tax credits. However, the statute permits a firm to be granted 2 allocations, or \$40 million in tax credits. The credits will be spread out over ten years, with \$3 million per year available from 2012 to 2015 and \$2 million per year available from 2016 to 2019, and can be offered to insurance companies in exchange for investment capital. Participating funds will be required to secure not less than \$14 million of net investment capital to receive a \$20 million tax credit allocation.

Although initially based on a more traditional “CAPCO” program model, the final legislation passed with some major changes from historical practice, including immediate vesting of the tax credits for participating insurance companies as well as a requirement to share 50% of the “profits” of the TNInvestco with the state. In addition, the government will have a significant hand in regulating the TNInvestcos’ operations, including limitations on management fees and expenses, requirements regarding the annual pace of investment, review and certification of specified qualifications to become a participating TNInvestco, regulation of distributions, “recycling” of investment proceeds and additional administrative guidance to come. Additionally, the legislation requires pre-investment approval before a Tennessee small business will be a permitted investment. Specifically, a Tennessee small business that qualifies as a permitted investment must be headquartered and have its principal business operations in the state, have no more than 100 total employees and have 60% of those employees located in Tennessee. Also, the Tennessee small business may not be principally engaged in rendering professional services, banking or lending, real estate development, insurance, oil and gas exploration or direct gambling activities. Financial penalties may be levied upon TNInvestco owners who do not meet the required pace of investment in Tennessee small businesses.

The program will be supervised by the Tennessee Department of Economic and Community Development and the Tennessee Department of Revenue. Applications to participate in the program are required to include the “fund documentation” and may be submitted beginning August 1 and must be submitted by October 1. Investment commitments are due November 1, 2009, and final participant determinations will be made by December 31, 2009.

2009 Tennessee Technical Corrections Bill Conditions Certain Exemptions Applicable to Private Equity Investors

Once again implementing a key legislative priority of Governor Phil Bredesen, the Tennessee General Assembly recently enacted the Tennessee Department of Revenue’s annual “Technical Corrections Bill,” which includes several provisions relating to Tennessee franchise and excise tax matters that are applicable to limited liability companies, limited partnerships or limited

liability partnerships, and thereby may be relevant for managers of private capital. Specifically, Revenue Commissioner Reagan Farr proposed and the General Assembly enacted the following condition to the availability of an important exemption from Tennessee's franchise and excise tax applicable to many venture capital and other private equity investors.

Annual Exemption Form Now Required. The new legislation now requires those entities relying on certain exemptions from the franchise and excise tax, including those utilizing the Venture Capital Fund exemption and the Diversified Investment Fund exemption, to file an annual application for exemption in order to retain exempt status for those entities. The annual application for exemption is now due on or before the 15th day of the fourth month following the close of the taxpayer's taxable year (i.e., October 15th for a taxpayer whose taxable year closes on June 30). Failure to timely file the annual application for exemption will result in a \$1,000 penalty and ultimately could result in the loss of that entity's exempt status.

We will continue to monitor these and other related developments and will distribute updates as and when appropriate. Bass, Berry & Sims PLC's Venture Capital and Private Equity Subgroup monitors and advises on developments in the area of venture capital, mezzanine and other private pools of capital. If you have any questions regarding the issues addressed in this Corporate and Securities Law Alert please feel free to contact any of your regular contacts in our Corporate and Securities Group or any of the attorneys in our Venture Capital and Private Equity Subgroup listed below.

Page Davidson	615-742-6253	pdavidson@bassberry.com
Riney Green	615-742-7866	rgreen@bassberry.com
Howard Lamar	615-742-6209	hlamar@bassberry.com
Ryan Thomas	615-742-7765	rthomas@bassberry.com
Tom Wedeles	615-742-7898	twedeles@bassberry.com
Michael Holley	615-742-7809	mholley@bassberry.com

Bass, Berry & Sims PLC Corporate and Securities Group

The Corporate and Securities Group includes the following subgroups comprised of our attorneys with a particular expertise who are focused on current trends and developments in these areas of the law. This Alert has been brought to you courtesy of the Private Equity/Venture Capital subgroup.

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315 Deaderick Street • Suite 2700 • Nashville, TN 37238-3001 • (615) 742-6200
The Tower at Peabody Place • 100 Peabody Place, Suite 900 • Memphis, TN 38103-3672 • (901) 543-5900
1700 Riverview Tower • 900 S. Gay Street • Knoxville, TN 37902 • (865) 521-6200