WISCONSIN STATE LEGISLATURE COMMITTEE HEARING RECORDS

2003-04

(session year)

Assembly

(Assembly, Senate or Joint)

Committee on Insurance (AC-In)

File Naming Example:

Record of Comm. Proceedings ... RCP

- 05hr_AC-Ed_RCP_pt01a
- 05hr_AC-Ed_RCP_pt01b
- 05hr_AC-Ed_RCP_pt02

COMMITTEE NOTICES ...

- Committee Hearings ... CH (Public Hearing Announcements)
- **

- Committee Reports ... CR
- **

- Executive Sessions ... ES
- **

- Record of Comm. Proceedings ... RCP
- **

INFORMATION COLLECTED BY COMMITTEE CLERK FOR AND AGAINST PROPOSAL

- Appointments ... Appt
- **

Name:

- Clearinghouse Rules ... CRule
- **

- Hearing Records ... HR (bills and resolutions)
- **03hr_ab0538_AC-In_pt02**

- Miscellaneous ... Misc
- **

FUND NEWS

Ohio Launches $100M Venture Program

Ohio's Governor **Bob Taft** signed into law on January 8 a bill that establishes the **Ohio Venture Capital (OVC) Program**, which will invest up to $100 million in seed and venture capital funds through a fund-of-funds. The state also established the **Ohio Venture Capital Authority** to administer the OVC program and establish its policies and guidelines.

The program will receive loans and investment from institutions such as banks and insurance companies for the fund-of-funds, which will invest in early-stage venture capital firms. Seventy-five percent of the funds must be invested in Ohio companies.

The legislation allows the Ohio Venture Capital Authority to grant lenders and investors of the OVC Program a total of $100 million in refundable tax credits. It is prohibited from granting more than $20 million in tax credits in any one fiscal year, and from granting a credit that may be claimed during the first four years of the OVC Program or after July 1, 2026.

Returns earned by the OVC's fund of funds will be used to repay the financial institutions that provided its initial capital. If there earnings from the fund of funds is somehow not sufficient to repay those loans, those financial institutions will be entitled to take a credit against their Ohio taxes.

Kevin Hughes, a policy assistant with the Ohio State Senate Republican Caucus and a former legislative aid to the bill's chief sponsor, State Senator **Jeffrey Armbruster**, says there was great demand for such a program. "I was impressed with the amount of commitment we received from the private sector in working to help this legislation along. We had people from all over the state who were really pushing and pulling for this to be passed." He says the program was originally the vision of former State Senator **Chuck Horn**, who sought to model it after ones that exist in other states, most notably Oklahoma.

Nine board members will manage the Ohio Venture Capital Authority. The state's director of development and tax comissioner will sit on the board along with seven others appointed by the governor.

The authority will designate one or two private, for-profit investment firms to serve as the program's administrator. One strong candidate to be a fund administrator is Cincinnati-based **Fort Washington Capital Partners**, the private equity arm of **Fort Washington Investment Advisors** with over $680 million under management.

"It's a great program," says **Stephen Baker**, vice president of Private Equity Direct Investments for the firm. "We've supported it from the beginning. The bill is attractive to us as a fund-of-funds manager." Baker says that the state's program is very similar to Fort Washington's **Tri-State Growth Capital Fund**, which invests in companies in Ohio, Northwest Kentucky, and Southeast Indiana.

"It's really going to help in the early stage side of enterprise innovation, which is the hardest capital to raise. We want to take venture capital to a level that's equal to a California or a Massachusetts or Texas. We're not there yet and have a long way to go, but we're moving in the right direction," says Baker. *—M.L.S.*

Intel on Pace, Despite Write-Downs

Despite a two-year losing steak that caused **Intel Corp.** to shave $841 million off its balance sheet, **Intel Capital** will not scale back its investment pace and expects to spend $200 million financing private companies in 2003.

Intel Capital wrote down $372 million off the value of its $1.1 billion investment portfolio last year, following a $469 million write-down in 2001. And its write-downs are expected to continue indefinitely, says Intel Chief Financial Officer **Andy Bryant**

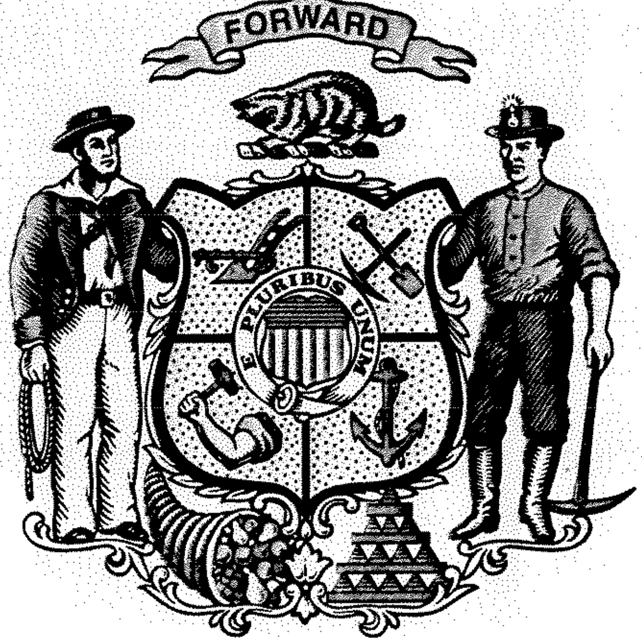
"There's still enough value left on the books to see sizable numbers [of write-downs] over the next quarters if we continue in an environment where financing is scarce, where companies have difficulties reaching breakthroughs and companies are having difficulties gaining customers," he told investors and analysts on a conference call last week.

Although Intel is not the only corporate investor to be dogged by write-downs — **JPMorgan Partners**, for example, took a $1.2 billion write-down in 2001 and continues to bleed red ink — it is a bellwether for early-stage technology investors because its portfolio is so large and so diversified.

It did not report the names of the companies it had to write down, but the firm is an investor in sectors that have been hit hard by the technology downturn, including Internet infrastructure and services and consumer wireless deals. The firm has shifted its investment focus in recent months, and plans to keep its place atop the list of most active venture capitalists.

Last year Intel Capital spent about $200 million investing in 100 portfolio companies. Two-thirds of those were follow-on investments, while the remainder was new deals. The firm expects to spend about the same in the coming year, but spend the bulk of that on new portfolio companies, says Intel Capital spokeswoman **Laura Anderson.**

The firm announced a $150 million push into WiFi in October, and also plans to bulk ups its portfolio with digital home computing technologies, server technologies and in modular computing. It recently closed its first nanotechnology deal, and will continue to fund companies developing sensors, MEMS sensors, semiconductors and fuel cells. *—C.B.*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E PLURIBUS UNUM

Definitions. In this subsection:

1. "Bona fide angel investment" means a purchase of an equity interest, or any other expenditure, as determined by rule by the department, that is made by any of the following:

a. An individual who reviews new businesses or proposed new businesses for potential investment of the individual's money.

b. A network of individuals who satisfy subd. 1.

2. "Claimant" means an individual who files a claim under this subsection.

3. "Qualified new business venture" means a business that is certified under s. 560.03 (26).

(b) *Filing claims.* Subject to the limitations provided in this subsection and in s. 560.03 (26), a claimant may claim as a credit against the tax imposed under s. 71.02 or 71.08, up to the amount of those taxes, an amount equal to 40 percent of the claimant's bona fide angel investment made directly in a qualified new business venture in the taxable year.

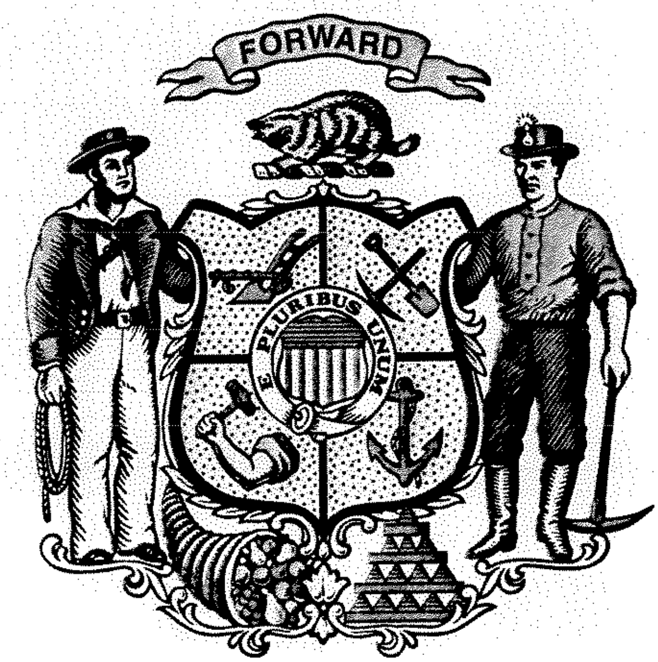
(c) *Limitations.* 1. The maximum amount of the credits that may be claimed under this subsection for all taxable years combined is $30,000,000.

2. The maximum amount of a claimant's investment that may be used as the basis for a credit under this subsection is $500,000 for each investment made directly in a business certified under s. 560.03 (26).

3. For a claimant who is a nonresident or part—year resident of this state and who is a single person or a married person filing a separate return, multiply the credit for which the claimant is eligible under par. (b) by a fraction, the numerator of which is the individual's Wisconsin adjusted gross income and the denominator of

1. It has its headquarters in the state.
2. At least 51 percent of the employees employed by the business are employed in this state.
3. Its average annual net income, if any, for each of the 2 taxable years immediately preceding the taxable year to which the certification applies does not exceed $5,000,000.
4. It's net worth, in any, in the taxable year to which the certification applies does not exceed $10,000,000.
5. It is engaged in, or has committed to engage in, manufacturing, agriculture, or processing or assembling products and conducting research and development or developing a new product or business process.
6. It is not engaged in real estate development, insurance, banking, lending, lobbying, political consulting, professional services provided by attorneys, accountants, business consultants, physicians, or health care consultants, wholesale or retail trade, leisure, hospitality, transportation, or construction.
7. It has less than 100 employees.
8. It has been in operation in this state for not more than 7 consecutive years.
9. It has not received more than $1,000,000 in investments that have qualified for tax credits under s. 71.07 (5d).

(b) In consultation with the department of revenue, promulgate rules to limit the aggregate amount of tax credits under s. 71.07 (Sd) that may be claimed for investments in businesses certified under par. (a) at $5,000,000 per taxable year.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Thank you colleagues for listening to me today.

I thank Senator Kanavas SB 321 who has worked very hard to negotiate this bill with the administration in an effort to find a way that we can accomplish a common goal.

Rank 47 in invest 4th in patents

How do we get investors to put their dollars here in Wisconsin? We need investors to choose Wisconsin.

One of the ways to encourage investment is to offer a tax incentive. This bill focuses on seed funding particularly by Angels. The original bill offered both an up-front tax credit, and a capital gains exemption when the investment in a new business is sold. The bill, as will be amended by the Substitute Amendment that has been distributed will remove the capital gains exemption and concentrate instead on the tax credit. It provides a new 40% tax credit while capping these credits @ $30M

It directs that a ~~study~~ survey of New Biz Ventures be published annually to determine new biz trends, barriers & obstacles

It directs Commerce to maintain an Internet listing of ~~Qual~~ New Biz Ventures

Risk/Reward

Compliments Venture cap investments

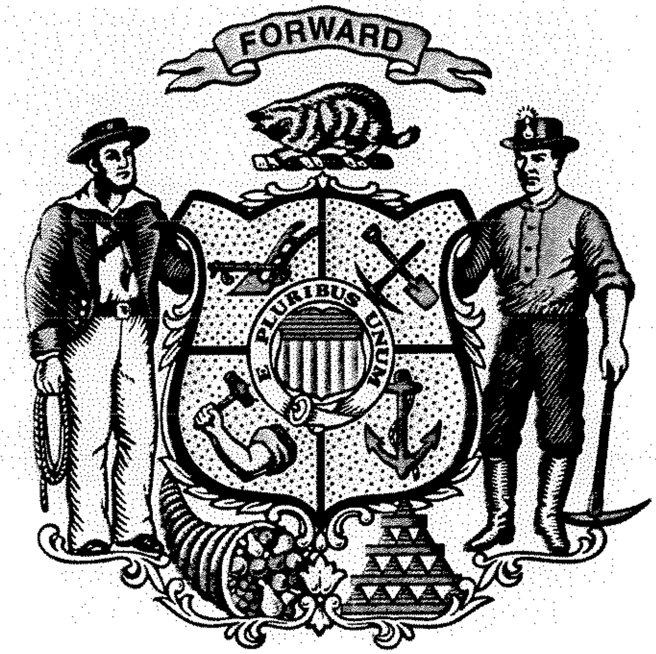
CapCos/successors

Joint Finance

Joint Com Tax Exemptions

Hubler ④

incubator-like benefits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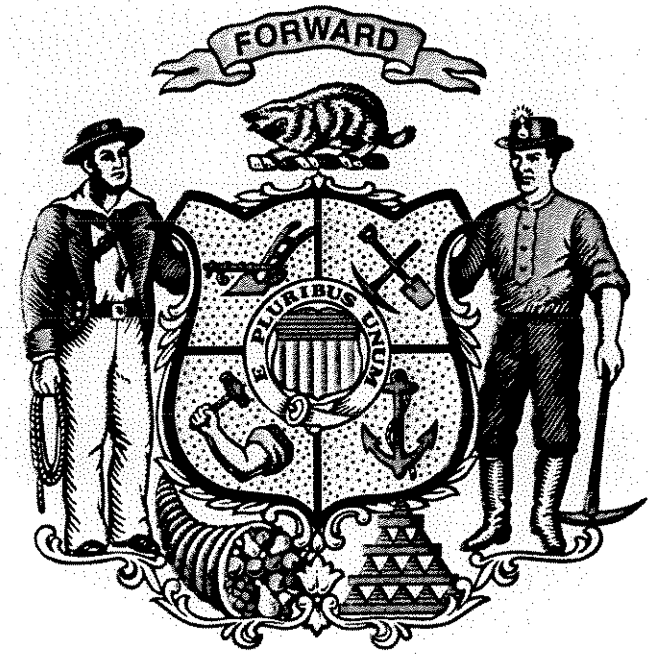
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AB 538

2003 – 2004 LEGISLATURE

LRBs0200/5
JK/MES/RJM:kg&jd:jf

12/1/2 Decker NO on adoption

Passage 10/4 as amended

Zien NO
?! Lasee
Decker
Coggs

SENATE SUBSTITUTE AMENDMENT ,
TO 2003 SENATE BILL 261

Fiscal effect $8M 06/07

① Annual Cert. process – Commerce already certifies pig for some tax credits – Comm says they may need another position

② 1000 limit

AN ACT *to amend* 71.05 (6) (a) 15., 71.08 (1) (intro.), 71.21 (4), 71.26 (2) (a), 71.34 (1) (g), 71.45 (2) (a) 10. and 77.92 (4); and *to create* 71.05 (6) (b) 9m., 71.07 (5d), 71.10 (4) (gx), 71.28 (5d), 71.30 (3) (eop), 71.47 (5d), 71.49 (1) (eop) and 560.03 (24) to (27) of the statutes; **relating to:** creating a qualified new business venture tax credit and increasing the capital gains exclusion regarding investments in certified venture capital funds and qualified new business ventures, requiring a study of new Wisconsin businesses, facilitating the development of certain investor networks, and granting rule–making authority.

Analysis by the Legislative Reference Bureau

This substitute amendment creates an income and franchise tax credit for investments in a new business venture that has its headquarters and the majority of its employees in this state. The substitute amendment requires a business desiring certification as a new business venture for purposes of this tax credit to apply to the Department of Commerce. To obtain certification, the business must be

Ted Don't pick winners or losers; creates environment to reward risk for making investment @ home

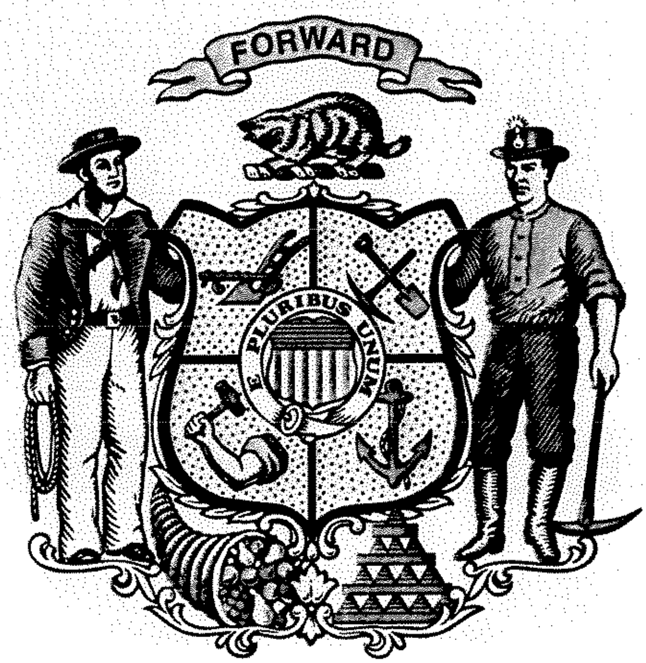
Incents behavior

WI 47th in start-ups

Push innov.

Econ Summit

Gov Doyle supports venture capital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Reform CAPCO

David Wonderwin

modify Cap Gains

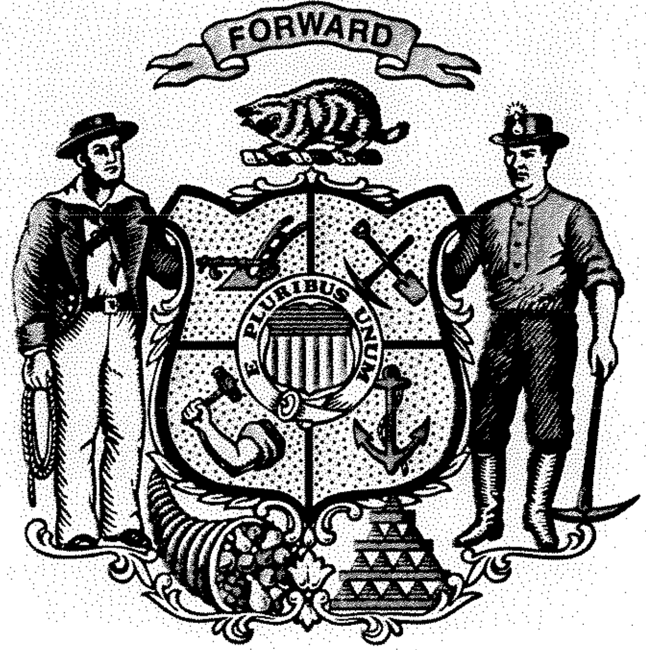
AB524 ?!

wildcard: McCormick

Riegelbauer

261/538 - Tax Exempt

$3M without $80M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A New Foundation

- Create a “New Business Venture” program

Focus & Streamline State Efforts
• Facilitate the selling of venture investments by providing incentives for broker-dealers to assist "Qualified New Business Ventures" raise capital

A qualified new Business venture (hereinafter QNBV) is:

1. A business which meets the CAPCO qualifications plus:
2. May not be predominantly engaged in Trade, or Leisure and Hopitality; and
3. Must have been formed as a Wisconsin entity within the prior 3 years; and
4. May not be more than 10 years old.

Tax credit available to a brokerage company or an independent broker

10% tax credit for first $500,000 of each venture investment offering. Multiple offerings will each get the tax credit. No cap on the number of offerings. But, one offering per entity.

Tax credit can be carried forward for 10 years.

Protection for investors is full and adequate disclosure as already required by law.

Could be certified as a QNBV by Dept. of Revenue or by Dept. of Commerce as appropriate. Either by self-declaration, subject to audit, or by application.

Focus & Streamline
State Efforts
• Create a "Qualified New Business Venture" tax credit for investors who invest in Wisconsin startup companies

This is a tax credit for individuals.

20% tax credit for the first $100,000 invested in a QNBV.
10% tax credit for amounts over $100,000 invested in a QNBV
no cap.

Individuals could carry tax credit forward for 7 years

Required to hold the investment in the QNBV for one (1) year. Tax credit can be taken in the year invested, but required to return the tax credit if the investment is not held for one year

Capital gains break (next section) is in addition to tax credit. No adjustment to basis is necessary because of the tax credit.

Focus & Streamline
State Efforts
• Create a "Qualified New Business Venture" tax deferral of the gain for rollover Wisconsin venture investments

This is in addition to the to any exclusion already provided by law for capital gains.

This rollover tax deferral is moving from one QNBV to another QNBV

For a long term (as currently defined by law of 1 year) 100% of the gain is deferred instead of 60%. For a short term investment 70% of the gain is deferred.

This tax deferral is for individuals.

There is no cap

The capital gain would be realized when the rollover is sold…and would receive the preferential treatment as otherwise provided herein.

This is in addition to any tax credit that may have been received for the original investment, and the rollover would have to decide between the tax credit and the rollover, but not both.

Focus & Streamline
State Efforts
• Provide a "Qualified New Business Venture" capital gains rate break for gains that are reinvested in Wisconsin start-up companies

For a capital gain from the sale of a house, stamp collection, stock or any asset, if the proceeds are invested in a QNBV then the capital gains rate is reduced:

> For a long term (as currently defined by law of 1 year) 100% of the gain is excluded instead of 60%. For a short term investment 70% of the gain is deferred.

The transaction must occur in the same tax year.

The choice is to accept the tax credit or the capital gains rate break, not both.

Focus & Streamline
State Efforts

- Provide a “Qualified New Business Venture” capital gains tax break for gains from venture capital investments that are reinvested in local tax-free bonds

This is a “Safe Out”. If an owner of a QNBV investment wants to move the risky investment into a tax free bond, there will be a reduced capital gain rate.

A “local tax-free bond” is the federally recognized tax-free bonds—municipal, and state.

For a long term (as currently defined by law of 1 year) 100% of the gain is excluded instead of 60%. For a short term investment 70% of the gain is excluded.

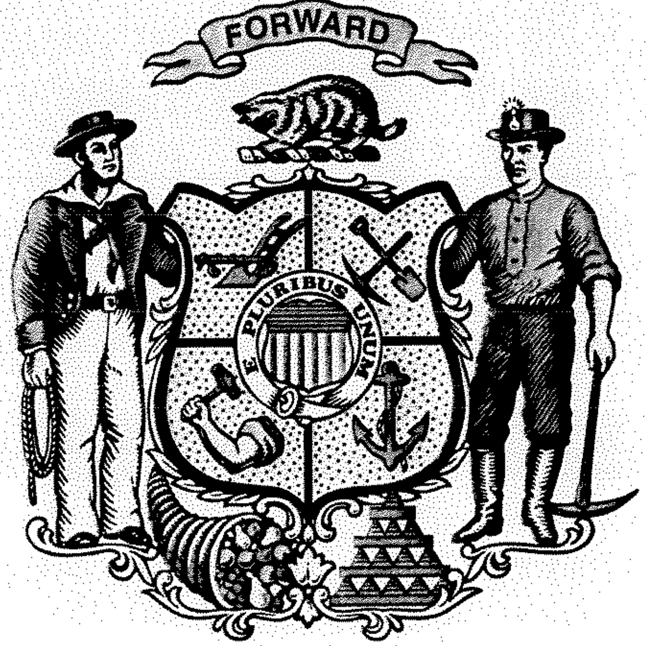
So, in the event that a QNBV is held for one year, its sale and reinvestment in a tax free bond is not a taxable event.

This is available even if a tax credit was taken on purchase of the QNBV.

Focus & Streamline
State Efforts

- Provide a 60% capital gains exclusion on state taxes for investments by entities in a "Qualified New Business Venture"

The purpose of this is to extend the current individual taxpayer gains exclusion to entities.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ISSUE PAPER

INCREASING VENTURE CAPITAL IN WISCONSIN

ISSUE:

Although it is generally agreed that Wisconsin needs to increase the amount of venture capital available to support "new economy" (high growth, high wage) companies, there is a lack of agreement as to the best method of achieving this goal. Today, both the Governor and Legislature have venture capital proposals that are being circulated for discussion.

Commerce is concerned that without a bi-partisan collaborative approach, the potential exists that none of the new venture capital proposals will be successful.

BACKGROUND:

The Governor's proposal, as presented in his Grow Wisconsin Initiative, is a $300 million program that would create a new authority designed to expand opportunities for new economy companies. In addition to increasing the availability of venture capital [$100 million from GPR, $100 million from the State of Wisconsin Investment Board (SWIB) and $100 million from Patient's Compensation Fund (PCF)], the authority would be charged with developing strategies designed to attract and assist Wisconsin's growing network of angel investors.

The legislature has two proposals that include a $300 million increase in the Certified Capital Company (CAPCO) program, expanded investment eligibility so that banks and utilities can participate (currently limited to insurance companies), and the creation of a Wisconsin Capital Investment Board to provide tax credits to institutional investors that invest in venture capital firms and angel investors that make investments in qualified businesses.

A quick analysis shows that none of the proposals are without issue. The Governor's position is that it is critical for venture funds to be made available for early stage seed investments. These high-risk investments will create a vibrant entrepreneurial environment that will pay long term dividends. The dilemma is that both SWIB and PCF would rather invest in later stage, lower risk companies that have demonstrated an ability to generate profits.

With regard to the legislative proposals, an assumption can be made that an expansion of the CAPCO program is perceived as being expedient since the program is already in existence in Wisconsin and is being used in several other states. Unfortunately, from an operational standpoint, the CAPCO program has several shortcomings. One of the most damaging is the program's high administrative cost. As it is currently structured, 50% or more of the funds provided to a CAPCO are immediately set-aside to cover these administrative costs. This leaves less than 50% available for investments in Wisconsin companies.

Even if a requirement is made that CAPCOs invest 100% of the funds allocated, it will not reduce the administrative costs of the program. Instead, an argument could be made that it will force the CAPCOs to make short-term investments in lower-risk projects in order to revolve the funds as necessary to meet the 100% requirement. In addition to failing to address administrative costs, this action will likely exacerbate another issue with the CAPCO program. Namely, getting the CAPCOs to invest in the type of high-wage, high-growth companies originally envisioned.

A second legislative proposal would establish a Capital Investment Board to allocate tax credits made available to individuals that invest in venture capital funds, community-based venture funds or in individual businesses. One of the concerns with this proposal is that there are no requirements that the Venture Capital firms invest in Wisconsin companies. Based upon its experience with the CAPCO program, Commerce is concerned that a "best efforts" approach will not yield the level of benefit necessary to justify the investment of public funds (tax credits).

Notwithstanding the above, Commerce believes that there is an opportunity to combine the various proposals in a way that builds upon their strengths and ensure that the goals and objectives of both the Governor and Legislature are met.

PROPOSAL:

Please reference the attached diagram as you review this proposal:

WISCONSIN CAPITAL AUTHORITY

It is recommended that legislation be passed that would

1. Create a Wisconsin Capital Authority charged with managing the state's venture capital investments and expanding opportunities for high-growth, high-wage businesses.
2. Authorize the Authority to solicit $175 million in private sector investments that would qualify for $175 million in tax credits.
3. Authorize the Authority to distribute $100 million to Certified Capital Companies (CAPCOs) under a new model that utilizes a Request For Proposal (RFP) process.
4. Authorize the Authority to establish a $75 million early stage seed fund.
5. Authorize the Authority to allocate $25 million in tax credits to Wisconsin's growing network of angel investors

Description

- A quasi-public entity that can make equity investments in private companies
- Administered by an Executive Director and 2-3 staff
- Oversight by a Capital Authority Board that would be comprised of legislators, cabinet members and individuals representing the institutional investors and private sector.

Key Functions

1. Solicit $175 million of investment from institutional investors (insurance companies, banks, utilities, S&Ls, etc.). In return for their investment, the institutional investor would receive a tax credit (10% yr for 10 years), a return on the venture capital funds the Authority invests in as well as a return on the Authority's early stage seed fund.
2. The Authority would draft a Request for Proposal (RFP), evaluate applications received and invest $100 million in accordance with a written Fund Allocation Plan approved by the Board. These funds would be invested in venture capital firms selected to become Certified Capital Companies (CAPCOs).
3. The Fund Allocation Plan would also include a recommendation to SWIB and PCF regarding the establishment of side-by-side investment agreement with selected CAPCOs. Note: It is expected that side-by-side agreements would only be entered into with a limited number of funds, i.e. The $200 million from SWIB and PCF would not be available to all CAPCOs.
4. The Authority would also manage a $75 million early stage seed fund that would be used to make small investments of $250,000 - $500,000. The companies assisted by the seed fund would subsequently seek follow-on funding from the CAPCOs.

5. The Authority would also manage the disbursement of $25 million in tax credits that would be available to angel investors that invest in qualified early stage companies. The credit would be 20% of the investment up to $50,000.

Benefits

1. The new model would eliminate the excessive administrative costs associated w/the current CAPCO program. Note: Although the insurance company investment would no longer be risk-free, the tax credits would be irrevocable which would mitigate a significant portion of the investor's risk.
2. The new CAPCO program would expand the number and type of venture capital firms that could participate in the program to include established firms such as Baird Venture Partners and Mason Wells. Under the current model, Baird is precluded from participating due to its relationship with Northwest Mutual Life (NML) and Mason Wells has chosen not to participate in the existing CAPCO model.
3. CAPCOs would be selected based upon their response to a comprehensive RFP. As a result of this vetting process, a review of the CAPCO's annual audit will be sufficient to determine program compliance. This will eliminate the need for oversight on an individual investment basis.
4. The new model would also allow for a small percentage of the CAPCO funds (no more than 5%) to be targeted toward venture capital firms that could use the funds to leverage additional federal funds and focus investments on under-served markets such as minority business enterprises or rural markets.
5. The costs associated with establishing and maintaining the Authority could be derived in a manner consistent with traditional venture capital models. As such, the Authority would not require GPR funds to operate.
6. The Authority's early stage seed fund would work closely w/Commerce's new Office of Entrepreneurial Development to help increase federal funding (SBIR & STTR) in Wisconsin. In addition, the Authority would also work with Wisconsin Alumni Research Foundation (WARF), Wisconsin Systems (WiSys), Medical College of Wisconsin (MCOW), Marshfield Clinic, etc., and the state's growing network of Angel Investors to coordinate services to high-tech entrepreneurs and avoid duplication of services.

Fee Structure

The administrative costs associated with this proposal would be consistent with traditional venture capital models in which the fund manager receives an annual management fee of 2-2.5%. For the sake of the following discussion, it is assumed that the CAPCOs will experience positive returns on their investments. However, since these investments will generally be higher risk, their is no guarantee of positive results and all of the funds should be considered "at-risk".

CAPCOs - The CAPCO's administrative costs would be limited to a management fee of 2.25% on the funds under their management ($300 million). They would also be allowed to draw 20% of the investment returns remaining after the principal has been returned to the Institutional and Public Investors.

Institutional Investors - Institutional investors would receive the tax credits (10% yr. for 10 years), a return of their original investment, and 60% of the gain attributed to their investment in the CAPCOs and Early Stage Seed Fund.

PCF & SWIB - The public investors (SWIB & PCF) would receive their original investment and 80% of the gain attributed to their investment.

Authority - The Authority would receive a .25% management fee on the $100 million passed through to the CAPCOs and 20% of the gain attributed to the contribution of the Institutional Investors in the CAPCOs. These gains will be reinvested in order to maintain the early stage seed fund on an ongoing basis. The Authority would also draw a fee for managing the $75 million Early Stage Seed Fund and receive 40% of the gains.

Early Stage Seed Fund

Why is the Seed Fund managed by the Authority rather than an existing venture capital fund?

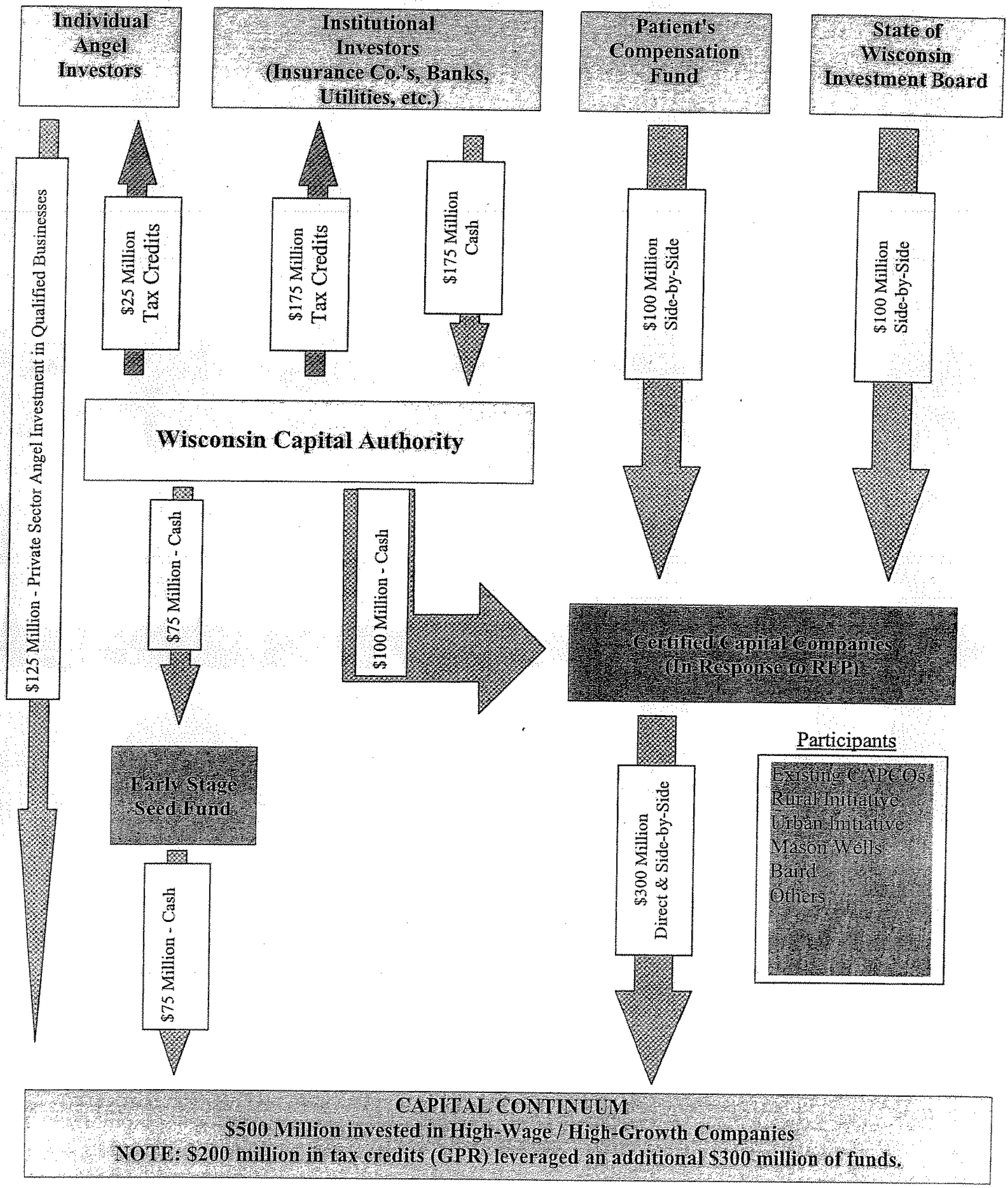
1. Since the Seed Fund will be a development fund for emerging companies, having it controlled by one firm would provide that firm with an unfair advantage.
2. Disbursing a portion of the Seed Fund to each of the successful CAPCOs so that they can establish their own seed fund would not be an efficient use of assets. In addition to diluting the impact of the fund, you would be asking the VC's to undertake a new role. Few of Wisconsin's VC firms have provided the type of early stage seed funding envisioned by this proposal.
3. The seed fund will also work closely with the angel investors that apply for tax credits as it is likely that in many cases, both the Authority and angel investor's will be participating in the same projects.
4. To maximize impact, the Authority will need to work closely with Commerce, WARF, WiSys the Small Business Development Center's, MCOW, Marshfield Clinic and others in order to maximize deal flow. A single quasi-public authority will be able to accomplish this much more effectively than multiple VC firms acting on their own.
5. After the seed round, it is likely that there will be a new valuation of the company prior to funding by a more traditional VC firm. This could cause problems if the seed fund manager is a competing VC firm.

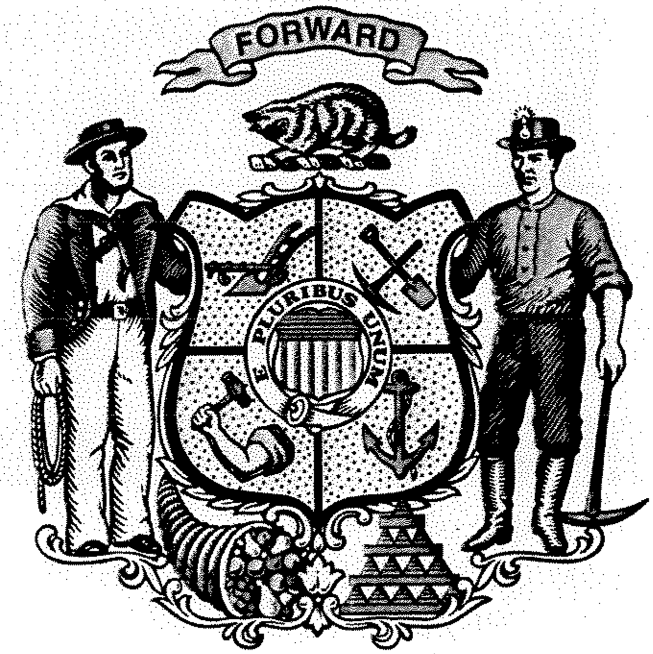
Conclusion

This proposal was designed to incorporate components from all existing initiatives and is intended benefit Wisconsin's long-term economic growth. Commerce looks forward to discussing specific aspects of the proposal in greater detail and is hopeful that in the end, Wisconsin puts forward a new venture capital initiative that will serve as a model for other states.

It should be noted that the proposal outlined above does not envision the type of centralized technology center that can be found in other states. Instead, Commerce anticipates that the Authority will collaborate with key partners to coordinate and enhance the wide array of services that are currently available to Wisconsin entrepreneurs. These key partners would include, but not be limited to Commerce, WARF, WiSys, MCOW, Wisconsin Innovation Service Center, SBDC, Milwaukee School of Engineering, Marshfield Clinic, Marquette University, etc.

Venture Capital Proposal

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IN RESPONSE
to your recent request, we are pleased to send you the attached material

Mary Jan,
Here's the Stuff I told you in my email that I was messengering over.

Dan R.
266-0341