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(FORM UPDATED: 08/11/2010)

WISCONSIN STATE LEGISLATURE ... PUBLIC HEARING - COMMITTEE RECORDS

2005-06

(session year)

Senate

(Assembly, Senate or Joint)

Committee on ... Job Creation, Economic Development and Consumer Affairs (SC-JCEDCA)

COMMITTEE NOTICES ...

- Committee Reports ... **CR**
- Executive Sessions ... **ES**
- Public Hearings ... **PH**

INFORMATION COLLECTED BY COMMITTEE FOR AND AGAINST PROPOSAL

- Appointments ... **Appt** (w/Record of Comm. Proceedings)
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- Hearing Records ... bills and resolutions (w/Record of Comm. Proceedings)
 - (**ab** = Assembly Bill) (**ar** = Assembly Resolution) (**ajr** = Assembly Joint Resolution)
 - (**sb** = Senate Bill) (**sr** = Senate Resolution) (**sjr** = Senate Joint Resolution)
- Miscellaneous ... **Misc**

Senate

Record of Committee Proceedings

Committee on Job Creation, Economic Development and Consumer Affairs

Senate Bill 290

Relating to: claiming early stage seed and angel investment income and franchise tax credits.

By Senators Kanavas and Olsen; cosponsored by Representatives Nischke, Van Roy, Albers, Hahn, Lothian and McCormick.

August 19, 2005 Referred to Committee on Job Creation, Economic Development and Consumer Affairs.

August 23, 2005 **PUBLIC HEARING HELD**

Present: (5) Senators Kanavas, Zien, Reynolds, Lassa and Decker.
Absent: (0) None.

Appearances For

- Mr. Aaron Olver, Madison — Wisconsin Department of Commerce
- Mr. Terry Grosenheider, Madison
- Mr. Tom Still, Madison — Wisconsin Technology Council
- Mr. Joe Kremer, Madison — Wisconsin Angels Network
- Mr. Joe Boucher, Madison
- Mr. Joe Hildebrandt, Waunakee
- Mr. Ron Kuehn, Madison — Wisconsin Biotech & Medical Device Association

Appearances Against

- None.

Appearances for Information Only

- None.

Registrations For

- Mr. Jim Hough, Madison — Wisconsin Economic Development Association
- Ms. Carrie Templeton, Madison — Wisconsin Department of Financial Institutions

Registrations Against

- None.

August 25, 2005

EXECUTIVE SESSION HELD

Present: (5) Senators Kanavas, Zien, Reynolds, Lassa and Decker.

Absent: (0) None.

Moved by Senator Kanavas that **Senate Bill 290** be recommended for passage.

Ayes: (5) Senators Kanavas, Zien, Reynolds, Lassa and Decker.

Noes: (0) None.

PASSAGE RECOMMENDED, Ayes 5, Noes 0

Jeremy Shepherd
Committee Clerk

SENATE BILL 290 (LRB -3051)

An Act to repeal 71.07 (5d) (c) 3.; to renumber and amend 71.07 (5b) (b), 71.28 (5b) (b) and 71.47 (5b) (b); to amend 71.07 (5d) (a) 1. a., 71.07 (5d) (a) 1. b., 71.07 (5d) (b), 560.205 (3) (d), 560.275 (2) (b) and 560.275 (2) (c); and to create 71.07 (5b) (b) 2., 71.07 (5d) (a) 2m., 71.07 (5d) (c) 3m., 71.28 (5b) (b) 2. and 71.47 (5b) (b) 2. of the statutes; relating to: claiming early stage seed and angel investment income and franchise tax credits. (FE)

2005

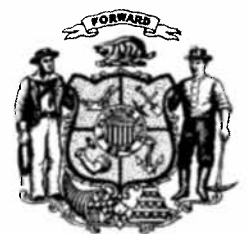
08-19.	S.	Introduced by Senators Kanavas and Olsen ; cosponsored by Representatives Nischke , Van Roy , Albers , Hahn , Lothian and McCormick .	
08-19.	S.	Read first time and referred to committee on Job Creation, Economic Development and Consumer Affairs	327
08-23.	S.	Fiscal estimate received.	
08-23.	S.	Public hearing held.	
08-25.	S.	Executive action taken.	
08-26.	S.	Report passage recommended by committee on Job Creation, Economic Development and Consumer Affairs, Ayes 5, Noes 0	333
08-26.	S.	Available for scheduling.	
09-14.	S.	Fiscal estimate received.	
09-21.	S.	Placed on calendar 9-27-2005 pursuant to Senate Rule 18(1).	
09-27.	S.	Read a second time	368
09-27.	S.	Referred to joint committee on Finance	368
09-27.	S.	Withdrawn from joint committee on Finance and taken up	368
09-27.	S.	Senate amendment 1 offered by Senator Kanavas (LRB a1066)	368
09-27.	S.	Senate amendment 1 laid on table	368
09-27.	S.	Senate amendment 2 offered by Senator Kanavas (LRB a1078)	368
09-27.	S.	Senate amendment 2 adopted	368
09-27.	S.	Ordered to a third reading	368
09-27.	S.	Rules suspended	368
09-27.	S.	Read a third time and passed , Ayes 32, Noes 0	368
09-27.	S.	Ordered immediately messaged	368
11-01.	A.	Received from Senate	564
11-01.	A.	Read first time and referred to committee on Rules	564
11-01.	A.	Placed on calendar 11-8-2005 by committee on Rules.	
11-08.	A.	Read a second time	593
11-08.	A.	Ordered to a third reading	593
11-08.	A.	Rules suspended	593
11-08.	A.	Read a third time and concurred in	593
11-08.	A.	Ordered immediately messaged	593
11-09.	S.	Received from Assembly concurred in	446
11-10.	S.	Report correctly enrolled on 11-10-2005	453

2006

01-04.	S.	Presented to the Governor on 12-30-2005	517
01-04.	S.	Report approved by the Governor on 1-4-2006. 2005 Wisconsin Act 97	516
01-11.	S.	Published 1-19-2006	521



WISCONSIN STATE LEGISLATURE





**WISCONSIN
TECHNOLOGY
COUNCIL**

Misc
SB 290?

August 23, 2004

TO: Members of the Senate Committee on Job Creation, Economic Development and Consumer Affairs, Sen. Ted Kanavas, chairman

FROM: Tom Still, president, Wisconsin Technology Council and Wisconsin Innovation Network

Thank you for the opportunity to address this committee as it considers possible next steps in the continuing effort to build a high-tech, high-growth Wisconsin economy.

The passage of Wisconsin Act 255 has been a model for state government in the area of economic development. It was written and passed with bipartisan support; Republicans and Democrats alike took part. Both the legislative and executive branches of state government were fully involved. It is leveraging private investment and action through public policy – and in full realization that results may not be fully apparent for years.

And, perhaps most important, it has highlighted and reinforced a dramatic change in how state government is approaching the state's economic development. Act 255 has underscored the state's commitment to growing our new economy from the ground up, rather than relying on old methods of chasing smokestacks that are no longer there.

The act does so through a mix of strategies, most of which you will hear more about today from others who will testify. They include tax credits aimed at encouraging angel investors and venture capitalists to invest more in Wisconsin, a variety of refocused technology grant and loan programs through the Wisconsin Department of Commerce,

the creation of the Wisconsin Angel Network as a “network of networks,” and the birth of the Wisconsin Entrepreneurs’ Network.

The thrust of Act 255 is also very consistent with other major initiatives in the technology development arena. For example, the Wisconsin Technology Council produces the statewide Governor’s Business Plan Contest, the Wisconsin Entrepreneurs’ Conference, the upcoming Wisconsin Early Stage Symposium (Oct. 19-20) and a variety of events through the Wisconsin Innovation Network. In each of these programs, the emphasis is placed on helping early-stage companies and entrepreneurs.

One of the consequences of Act 255 has been better coordination of Wisconsin’s resources in the early-stage area. For example, the creation of the Wisconsin Angel Network through the Wisconsin Technology Council has led to greater communication with angel networks and individual angel investors. That has prompted more understanding of their needs, and the development of an online inventory of early-stage companies that appears to be the first of its kind in the nation.

By learning more about the interests and needs of angel investors, we also better understand the links between angel investment and other forms of private equity, such as venture capital. For years, Wisconsin has wondered why it has not attracted more venture capital, especially from investors outside the state. One reason is that those investors have not always found the fully-formed deals that they wanted to find. By helping angel networks find deals across Wisconsin, we are planting the seeds for tomorrow’s venture investment.

I'm not suggesting that Wisconsin should abandon efforts to attract business from outside its borders. On the contrary, Wisconsin should be far more aggressive at doing so – perhaps emphasizing efforts to pursue investors and the kind of talent that can take young companies to the next step. Wisconsin should have a strong presence at events such as the upcoming BIO International Convention in Chicago in April 2006, it should pursue events such as the BIO Midwest Convention in 2007, and it should consider capitalizing on recent press attention by sending “venture missions” to the East and West Coasts.

We also need to hammer home the message that building Wisconsin's economy will not be accomplished by Stevens Point trying to one-up Wausau, or Milwaukee trying to out-compete Madison. Wisconsin can only prosper by finding its niche in a 21st century economy that is truly global in nature. We must look to the strengths of the “I-Q Corridor,” which stretches from Chicago to the Twin Cities, encompassing most of Wisconsin in between, and think about selling ourselves to the world as a region.

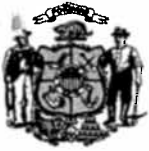
The world has changed. Nations such as China and India are economic powers in ascendance. We cannot compete with them on labor costs, but we can compete through ideas, innovation, intellectual property, investment and interstate cooperation – the “Is” of the I-Q Corridor. And we can do so while offering quality of life, environment, education and workforce.

Act 255 is focused on building Wisconsin from within so it can compete far outside its borders. The Legislature can be proud of its role so far, and should be commended for looking for ways to build upon Act 255's foundation.

Thank you for the chance to speak.

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State of Wisconsin • DEPARTMENT OF REVENUE

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Jim Doyle
Governor

Michael L. Morgan
Secretary of Revenue

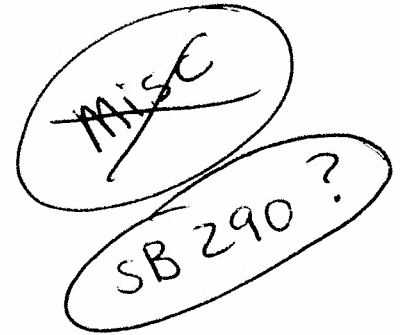
MEMORANDUM

March 28, 2005

TO: Mary P. Burke
Secretary of Commerce

FROM: Michael L. Morgan *MUM*
Secretary of Revenue

SUBJECT: Early Stage Seed Investment Credit



2003 Act 255 created the early stage seed investment credit. Effective for taxable years beginning after 2004, the credit is available for 25% of investments in qualified new business ventures that meet certain requirements and are certified by the Department of Commerce. The total amount of credits that may be claimed is \$3.5 million per taxable year and \$35 million for all taxable years.

As drafted, the law contains ambiguities regarding the allocation of credits to partners, members and owners of pass-through entities. In one section of the act, the law states that the credit is 25% of the claimant's initial investment. In another section, the act says that the credit can be specially allocated in the organizational documents of the pass-through entities.

In the attached memorandum to me, Mr. Neis suggests language to clarify that the credit may be specially allocated. The language suggested by Mr. Neis is lengthy and complicated and may be in conflict with the computation of federal taxable income that is the starting point for determining Wisconsin taxable income.

The Department of Revenue suggests the following alternative to allow for special allocation arrangements of pass-through entities: amend sections 71.05 (5b)(b), 71.28 (5b)(b) and 71.47 (5b)(b) as follows:

1. Except as provided in subd. 2, for taxable years beginning after December 31, 2004, subject to the limitations provided under this subsection and s. 560.205, a claimant may claim as a credit against the tax imposed under ss. 71.02 and 71.08, up to the amount of those taxes, 25 percent of the claimant's initial investment paid in the taxable year to a fund manager that the fund manager invests in a business certified under s. 560.205(1).
2. In the case of a partnership, limited liability company or tax-option corporation, computation of the 25 percent limitation under subd. 1 is determined at the entity level rather than at the claimant level and may be allocated among the claimants making initial investments in such

manner as the entity's organizing documents set forth. The entity shall furnish to the department and the Department of Commerce the names, tax identification numbers of the claimants, amounts of the credits allocated and computation of the allocation of the credits.

I would welcome any comments or concerns you may have about this approach.

Attachments

cc: John Neis

✓Senator Theodore Kanavas

-----Original Message-----

From: John Neis [mailto:John@ventureinvestors.com]
Sent: Monday, December 13, 2004 12:34 PM
To: michael.morgan@dor.state.wi.us
Cc: Olver, Aaron - COMM
Subject: Act 255

Dear Secretary Morgan,

Senator Ted Kanavas encouraged me to contact you about a proposed legislative clean-up to Act 255. I have worked closely with Wisconsin's venture capital funds in advising the Department of Commerce on the drafting of the rules for Act 255. We believe that the Early Stage Fund component of the legislation can be an effective tool to help address Wisconsin's shortage of venture capital. However, a legislative clean-up is necessary to enable the funds to align the interests of fund investors and allow fund managers to consider the tax credits in their investment decisions without breaching their fiduciary duty.

Several parties have questioned whether the Department of Revenue would object to this change, wondering whether it would impose an administrative burden. We believe that it imposes little or no administrative burden at the Department of Revenue, and would in fact potentially ease any burden by assisting the Department in tracking and confirming a taxpayer's eligibility to claim the tax credits made available in the Act.

I have attached a memo that Senator Kanavas requested which provides a detailed review of the issue and our proposed solution. I would be glad to respond to any questions you have about the proposal and would be pleased to meet with you or members of your staff at your convenience if you wished to discuss this matter in greater depth.

Thanks for your consideration.

John Neis, CFA
Senior Partner

VENTUREINVESTORS LLC
University Research Park
505 South Rosa Road
Madison, WI 53719

1/13/2005

December 11, 2004

Memorandum

To: Senator Ted Kanavas

From: John Neis

Regarding Act 255 Legislative Amendment regarding Special Allocation

I have tried to work closely with the Department of Commerce by providing input in the drafting of the rules for Act 255, focusing my attention on the Early Stage Fund portion of the legislation where I have relevant experience. I have worked together with the other venture capital firms in the state and attempted to help the DOC understand the practical implications of the proposed language. I believe that they have thoughtfully considered our input, and while we aren't getting everything we want, they have shared their rationale where we differ, and I believe that it is consistent with legislative intent with a good chance of being effective.

However, at this point, there is one fundamental flaw in the legislation that the DOC does not believe can be resolved with the rules and will require legislative clean-up. Without a clean-up, the credits will either be diluted to a point where they are meaningless in the decision making of investors, or they will create conflicts of interest that prevent fund managers from consider the tax credits in their decision making because it would result in a breach of their fiduciary duties.

I believe the purpose of the Early Stage Fund tax credits in Act 255 was twofold. First, it was to expand the pool of investors willing to invest in Wisconsin focused venture capital firms. Second, it was to encourage those funds to place a greater emphasis on early stage Wisconsin companies. The Act provides for a tax credit to the investors in a fund at the time of the fund's investment in a qualified Wisconsin business. The credit is for 25% of the amount invested, but rules are limiting the credits to investments in companies in the earliest stages of their development and capping the amount of the credit available to any single investor in a company and to all investors in a company in aggregate. Since funds typically try to stage the funding over time and the funds have historically invested far more than the proposed caps in individual companies, the credits are expected to be far less than the 25% of the amounts invested in Wisconsin companies.

Let me describe a realistic example that will highlight the need for a legislative cleanup. Assume that a Wisconsin venture capital firm is able to raise a \$100 million fund. Assume 60% of the investors are tax exempt (below the national average of 64%) and 20% were from out-of state sources that didn't pay taxes in Wisconsin. In a typical fund structure, operating expenses for the team of fund managers are subtracted from this amount at a rate of 2% per year over a ten year fund life, leaving \$80 available for investment. Of this assume they invested 75% (\$60 million) in Wisconsin (this would be extraordinary since only 33% of venture capital nationally is invested in the same state the venture capital firm is based). Of the Wisconsin investments, assume two-thirds (\$40 million) were in qualified early stage businesses (again, extraordinary since only 20% of venture capital investments nationally go into early stage investments). Based on its investment activity, investors in this fund should be eligible for \$10 million in tax credits. An incentive of \$0.10 per \$1.00 invested is modest considering that funds need to return an average of \$3.00 to \$4.00 over time to remain competitive nationally and continue to attract investors. A tax credit of \$0.10 towards that goal is a modest attraction to consider investing in a Wisconsin fund as opposed to a California or Massachusetts fund. Unfortunately, the legislation as drafted would limit the tax credit for the investors in this fund to \$5 million, penalizing them for their investor mix. With a credit of only \$0.05 per dollar invested in a illiquid fund with a ten year life, the credit is reduced to a meaningless incentive to invest in the fund.

The source of investor capital for the venture capital industry in 2003 was typical of the industry experience for the last decade. Public and private pension funds accounted for 43% of the commitments to the venture capital industry and foundations and endowments were the source of another 21%. These tax exempt entities are focused on return on investment. One of the great strengths of Act 255 is the recognition that artificial geographic constraints (either prohibiting out-of-state investments or requiring a certain percentage of investments in a state) are widely recognized as having a negative impact on return on investment because they interfere with the selection of the best available investment opportunities. The genius of Act 255 is that instead of a fixed credit and the imposition of a geographic constraint (the former helping returns the latter reducing them), it simply offers the credit to make the early stage Wisconsin company more attractive and grants the credit when the investment is made. Thus, the bill provides the capacity to remain focused on return on investment and retain the interest of these significant tax exempt investors. However, these investors are also highly sensitive to the alignment of the interests of all investors. If tax credits are available to certain investors (including fund managers), but not the tax exempt investor or investor domiciled outside the state, those investors naturally question whether this could reduce their returns. (For example, if Company A in Illinois is slightly more attractive than Company B in Wisconsin, they would want the fund managers to fulfill their fiduciary duty and invest in Company A. However, if the inclusion of the tax credit makes Company B a more attractive investment for certain investors including the fund managers, it creates a conflict of interest for the fund manager because his self interest is in conflict with the best interests of his tax exempt limited partners.) As a result, availability of tax credit benefits to only some investors has the potential to attract some investors while contributing to the loss of other investors, particularly those groups that have historically been the biggest investors in the asset class. As a result, fund managers need the ability to equitably share the benefits of the tax credits across all its investors to be able to consider the tax credits and favor a Wisconsin based early stage company because of them.

Act 255 did contemplate the value of being able to reallocate tax credits within a fund to those investors that could use them. Without that ability, the total tax credits available in the example above would have been reduced further from \$5 million to \$2 million. Sections 71.07(5b); 71.28(5b); and 71.47(5b) (providing for credits to be claimed against individual and corporate income and franchise taxes) of the newly adopted statutes each provides, in subsection (c)(2), that:

Partnerships, limited liability companies, and tax-option corporations may not claim the credit under this subsection, *but the eligibility for, and the amount of, the credit are based on their payment of amounts under par. (b).* A partnership, limited liability company, or tax-option corporation shall compute the amount of credit that each of its partners, members, or shareholders may claim and shall provide that information to each of them. Partners, members of limited liability companies, and shareholders of tax-option corporations may claim the credit in proportion to their ownership interest *or as specially allocated in their organizational documents.* [Emphasis added.]

Sections 71.07(5b)(b), 71.28(5b)(b), and 71.47(5b)(b) limit early stage credits to "25% of the claimant's . . . investment . . ." We thought it was clear that Subsection (c)(2) of each section makes it clear that, for purposes of calculating this 25% cap, the limited partnership, limited liability company, or tax-option corporation is deemed to be the claimant. The statutes do not explicitly say that limited partners in a limited partnership may receive tax credits in excess of 25% of their individual investments in the limited partnership, but it is certainly implied by the above-cited statutory language. Otherwise, the statutory references to special allocations would be meaningless. (It is my understanding that it is a basic tenet of statutory construction that a statute may not be construed in such a way as to render any of its provisions meaningless.) However, we learned from the DOC that there is a strict interpretation of the definition of "Claimant", and that it refers to the individual investor, not the fund.

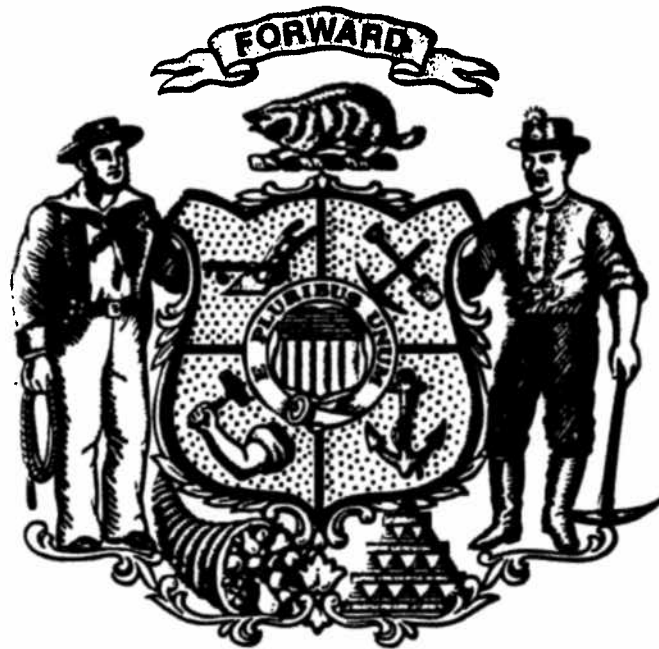
I want to address the potential that there may be some concern among policymakers that the special allocation of tax credits in excess of 25% of an individual limited partner's investment in an early stage venture fund could result in a "windfall" to certain investors. It could be argued that it should be left to the parties, negotiating at arm's length in a free market, to establish special allocations which are fair and reasonable to all parties. However, whether or not they are compelled to do so, it can be anticipated that most fund managers will want to put special allocations in place not only to maximize the benefits of participation in the Early Stage Program for the fund overall, but also to spread the benefits of the Program as equitably as possible among all investors as a means of avoiding internal conflicts of interest. I believe that this is also in the State's best interest because it would allow consideration of the credits in investment decision making. It would therefore seem reasonable to embody this concept in the legislation, if that would help allay concerns that the program might somehow be abused to create a windfall for specific investors.

To resolve this problem of conflict of interest and to broaden the appeal of the program and attract net investment into Wisconsin, we hope that the legislature will consider an amendment to the legislation along the lines of the following:

Sections 71.07(5b)(b), 71.28(5b)(b) and 71.47(5b)(b) shall not be deemed to prohibit a taxpayer from claiming a credit in excess of 25% of such taxpayer's investment in a taxable year in a partnership, limited liability company, or tax-option corporation, where: 1) the amount of the credit is based on the payment of amounts under Section 71.07(5b)(b), 71.28(5b)(b), or 71.47(5b)(b) by the partnership, limited liability company, or tax-option corporation; 2) the total credits claimed on behalf of all partners, members, or shareholders do not exceed 25% of the investments in businesses certified under s. 560.205(1) by the partnership, limited liability company, or tax-option corporation; 3) the amount of credit claimed by the taxpayer was specially allocated to the taxpayer in the organizational documents of the partnership, limited liability company, or tax-option corporation; and 4) the organizational documents provide for (a) additional capital contributions from those partners, members, or shareholders which are receiving allocations of credit in an amount which is disproportionately high in comparison to their ownership interest; or (b) offsetting distributions of cash or other property to those partners, members, or shareholders which are receiving allocations of credit in an amount which is disproportionately low in comparison to their ownership interest. The additional contributions of capital or offsetting distributions of cash flow shall be in an amount reasonably calculated to have the same value as the difference between the tax credits actually received and the tax credits which would have been received by such partners, members, or shareholders if they had been allocated credits proportionate to their ownership interests. Such calculations shall be deemed to comply with this section if (i) they are set forth in organizational documents which have been signed by the fund manager and each of the partners, members, or shareholders; and (ii) during the life of the fund, or, if sooner, within fifteen (15) years after the first year in which tax credits are allocated to a partner, member, or shareholder, the net tax credit benefit to such partner, member, or shareholder, measured as the value of tax credits allocated to, less the additional capital contributions paid by, or cash flow diverted from, such partner, member, or shareholder, does not exceed twenty-five percent (25%) of the total capital contributed by such partner, member, or shareholder to the partnership, limited liability company, or tax-option corporation. The foregoing rule shall also apply to any partnership, limited liability company, or tax-option corporation formed or reorganized for the purpose of investing, directly or indirectly, in the partnership, limited liability company, or tax-option corporation which makes the payments giving rise to the credits.

In anticipation of a concern possibly being expressed by the Department of Commerce or the Department of Revenue about the challenges this presents in tracking the credits, we offer a description of how easily this can be accomplished. As noted earlier, the legislation states "A partnership, limited liability company, or tax-option corporation shall compute the amount of credit that each of its partners, members, or shareholders may claim and shall provide that information to each of them." The funds are applying for the available credits to the Department of Commerce, and the credits are issued by the DOC. If the funds were simultaneously required to provide a copy to the DOC of the computation of the amount of credit that each of its partners, members, or shareholders may claim when they provide that information to each of them, the DOC will have a record of the allocation and be able to insure that the total claims match the allocated credits. As a result, there will be an easily verifiable record to provide assurance of no fraudulent claims without a meaningful regulatory burden.

As always, I'm am available at your convenience at (608) 441-2704 to answer any questions you have about these matters.



August 19, 2005

Memorandum

To: Committee on Job Creation, Economic Development and Consumer Affairs
Senator Ted Kanavas, Chairperson
Senator David Zien
Senator Tom Reynolds
Senator Julie Lassa
Senator Russell Decker

From: John Neis, Senior Partner, Venture Investors LLC

Regarding: Written testimony on Senate Bill 290

Thank you for providing the opportunity to comment on Senate Bill 290, which amends Act 255. I will focus my comments on an important technical change to the Early Stage Seed Investment Credit. My objective is to provide background information on the importance of this portion of Act 255, describe the problem and unintended consequences in the statute today, and describe how this change rectifies the problem.

The Importance

In a world of increasing national and international competition, it is critically important for Wisconsin to foster the development of industries offering the high skilled, high paying jobs of the next century. Fortunately, Wisconsin is blessed with one of the world's greatest research engines in its university system, which is capable of generating the kind of innovations that can provide sustainable competitive advantages to young companies that are competing internationally in the most rapidly growing sectors of the world's economy. However, a major obstacle to the successful commercialization of these technologies in our state is Wisconsin's lack of early stage venture capital. Despite having 1.85% of the nation's population and 2.22% of the nation's academic research spending, Wisconsin is the home for only 0.06% of the venture capital under management in the United States.

Wisconsin needs to develop a continuum of financing resources for its emerging companies. Angel investors typically provide modest amounts of capital to many companies in the formative stages. Venture capital firms typically provide much larger amounts of capital to those companies with the most ambitious objectives. Overall, venture capital has an enormous impact on the U.S. economy, with 9.4% of private sector employment in the U.S. being directly tied to venture capital investments between 1970 and 2003. These are high paying jobs that employ a disproportionate percentage of the nation's scientists, engineers and managers. Intel, Microsoft, Cisco Systems, Medtronic, Apple Computers, Genentech, Amgen, eBay, Google, Home Depot, Office Depot, and Federal Express are just a few examples of companies whose roots trace back to venture capital funding. Needless to say, these companies needed significant amounts of capital to get to where they are today, and the most difficult capital to obtain is the early stage capital that almost always is provided by local venture capital firms that are willing to have hands-on involvement. The

average initial round of venture capital funding in the United States is \$5.5 million, and many require tens of millions of dollars over time. If Wisconsin wants its stellar research engine to be a key driver of its economic future, our state needs to encourage the formation of pools of early stage venture capital to seed the formative stages of companies with significant commercial potential.

The Problem

The institutional investors that are the principal investors in early stage venture capital firms can invest their money in venture capital firms anywhere in the country. While they may recognize the potential in places like Wisconsin, our high tech sector is early in its development and relatively unproven compared to places like San Francisco, Boston, San Diego, and Austin. As a result, an investment in a Wisconsin based early stage venture capital firm is viewed as more risky and uncertain. Thus, they will naturally favor those markets where they have had success in the past. The tax credits offered in Act 255 were intended to close that gap, enhancing the potential return and reducing the perceived risk to encourage investors to shift a portion of their venture capital investments to Wisconsin based venture capital firms.

For the early stage venture capital portion of Act 255 to work, the venture capital firms need the capacity to structure their fund in a way that enables all of the investors in the fund, including tax exempt investors and out-of-state investors, to share equally in the incentives being offered. If that can not be done, the fund managers have a fiduciary duty to ignore the tax credits in their investment decisions. For example, assume that Company A in Illinois is slightly more attractive than Company B in Wisconsin without considering the tax credits and Company B is more attractive if the tax credits are considered. A fund manager has a fiduciary duty to operate in the best interests of all investors and can only consider the investment attributes that are uniformly shared by all investors. As a result, they would be forced to select Company A in Illinois, undermining the legislative intent. This would be bad enough, but the potential negative impact could be worse. If the inclusion of the tax credit makes Company B a more attractive investment for certain investors including the fund managers, it creates a conflict of interest for the fund manager because his self interest is in conflict with the best interests of his tax exempt limited partners. If tax credits are available to certain investors (including fund managers), but not the tax exempt investor or investor domiciled outside the state, those investors naturally question whether the fund manager will be operating in their self interest, reducing their expected returns. If they view this as a risk, use of Act 255 could actually discourage investment in Wisconsin based venture capital funds. As a result, availability of tax credit benefits to only some investors has the potential to attract certain types of investors while discouraging the participation of other types of investors, particularly the tax exempt investors that are the source of 60% of the investments into venture capital funds.

The sponsors of Act 255 had the foresight to recognize that it was important to make it possible to make the incentives available to all types of investors and encourage net investment into our state's economy. Act 255 created 71.28(5b)(c)2. of the statutes, which says "Partners, members of limited liability companies, and shareholders of tax-option corporations may claim the credit in proportion to their ownership interest or *as specially allocated in their organizational documents.*" (italics added). This provision enables the fund to be organized in a way that specially allocates

the tax credits to the Wisconsin tax paying investors and then allocates an offsetting portion of the gains to those investors that are not Wisconsin taxpayers, thereby creating an equal net benefit to all investors. This enables the program to appeal to investors of all types, and in the example above, the fund manager would now have a fiduciary duty to consider the tax credit in the investment decision since all benefit, and would select Company A in Wisconsin over Company B in Illinois.

Unfortunately, the use of the term "Claimant" undercut the broad appeal that was intended by determining the available tax credit based on the type of investors that invest in a venture capital fund rather than solely based on whether the venture capital fund makes the type of investments encouraged by the legislation. It penalizes those funds that are able to attract tax exempt investors and it discourages Wisconsin tax paying investors from investing in a fund that includes tax exempt investors. This would be counterproductive.

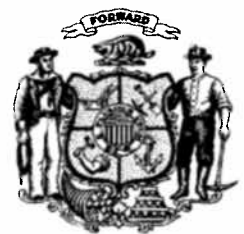
The Solution

Section 2 of Bill 290 eliminates this unintended consequence by making the computation of the tax credit at the entity level rather than the claimant level. It eliminates the discrimination between funds based on the type of investors that they are able to attract and only rewards them when they engage in the desired investment activity. Additionally, it adds a reporting requirement that helps the Department of Commerce and the Department of Revenue track the allocation of tax credits, reducing the administrative burden and insuring that only justified claims of tax credits are made.

I strongly encourage you to vote in favor of Senate Bill 290 as drafted. It incorporates important changes that will help make Act 255 an effective piece of legislation.



WISCONSIN STATE LEGISLATURE



Shepherd, Jeremy

From: Olver, Aaron - COMM
Sent: Wednesday, August 24, 2005 9:34 AM
To: Shepherd, Jeremy
Subject: Act 255 Statistics

SB 290 ?

Jeremy,

Here are the statistics that I presented yesterday.

Tax Credits

34 companies are currently qualified for tax credits as "Qualified New Business Ventures" (w/ more in the pipeline for approval - I said 33 in the hearing but the 34th was approved that afternoon)

Angel Tax Credits

\$1.07 million in angel tax credits have been awarded
\$4.3 million in angel investments have been leveraged with Act 255 tax credits

Venture Capital Tax Credits

4 fund managers have completed or are in the process of becoming certified to use Act 255 venture capital tax credits
3 of these are new funds to Wisconsin that did not exist prior to Act 255 (Note: They didn't necessarily form wholly because of Act 255)
1 of the funds has closed and made 2 investments (these have not drawn credits yet because of their structure)
There may be additional funds forming as well

Wisconsin Entrepreneurs Network

4 Regional Directors are in place (Madison, Milwaukee, Eau Claire, Green Bay)
Other specialists are in place (e.g., SBIR specialist)
50 outreach centers have been established to blanket the state
WEN Tracker in place to track entrepreneurs as they move through the system
Resource Navigator has 130 service providers listed and more will be added (esp. private sector providers)

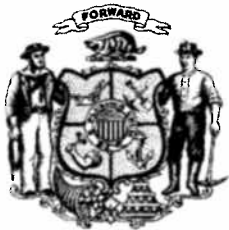
Technology Commercialization Grants & Loans

16 Start-up companies have been supported with assistance for patenting, applying for federal grants, or with seed capital

Aaron D. Olver
Office of the Secretary
Department of Commerce
608-266-8976



WISCONSIN STATE LEGISLATURE



**Committee on Job Creation, Economic Development and
Consumer Affairs, Senator Ted Kanavas, Chairperson**

SB 290?
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Date?

Senator, thank you for the opportunity to testify today.

My name is Terry Grosenheider. I serve on the Wisconsin Technology Council as Speaker Gard's designee and I am a member of the Wisconsin Economic Development Association. I am currently a Private Banker at U.S. Bank, but I am not appearing in that capacity today. From 1992 to 2000, I served at the Wisconsin Department of Commerce, and from 2000 to 2002, I served as the Deputy Secretary of the Wisconsin Department of Financial Institutions. My remarks today reflect my service in government, my interest in economic development and my faith in the future of Wisconsin.

We have made significant progress in the last five years in making Wisconsin a more investor friendly environment. I worked with many of you to champion those changes that have been made, but I am here today to tell you that there is more to be done. Why, you might ask. Well for one, Wisconsin is 47th among the states in business creation. Two, Wisconsin trails the nation in percentage of its citizens with masters and doctoral degrees. And three, while Wisconsin lags the nation in per capita income, our taxes are higher.

This is hardly the recipe for success. Yes, jobs within the existing economy are rebounding and the economy in general is strengthening, but the question we must ask ourselves is, "Where will higher incomes, new growth and new jobs come from?"

Committee on Job Creation, Economic Development and Consumer Affairs, Senator Ted Kanavas, Chairperson

To chart a better course we must engage the individual investor in building the Wisconsin economy. I applaud the steps that have been taken, in particular Act 255, but more must be done to improve the risk/reward ratio for Wisconsin investors. When asked to comment on today's relative lack of new business investment in Wisconsin, people often speculate that we are conservative investors because of our Germanic and Scandinavian heritage. While quaint, it fails to explain the great companies that have shaped the economic strength that we enjoy today. Miller Brewing, Allis Chalmers, Harley Davidson, Johnson Controls, Mercury Marine, Schneider Trucking, American Motors, Fort Howard and Consolidated Paper were all formed in the same ethnic environment by Wisconsin entrepreneurs who saw opportunity and took a chance based upon insight and skill. Many of these companies continue to thrive and contribute, while others are gone.

How could they have succeeded, while today we are looking for answers. That fact is, we have developed a conservative and restrictive investment environment. Today it is easier to legally gamble your life savings away than it is to invest in emerging, growth Wisconsin companies. Allow me to state that another way, there are more restrictions on investment in legitimate emerging growth Wisconsin companies than there is on gambling in the state of Wisconsin.

Let's put this in perspective. With Act 255, the legislature created a \$65 million package of investment tax credits spread over ten years. \$6.5 million

Committee on Job Creation, Economic Development and Consumer Affairs, Senator Ted Kanavas, Chairperson

per year. Wisconsin residents will legally wager \$6.5 million in the next 32 hours.

If we want to create new businesses and new jobs, we must make it easier to invest, not more difficult. There will be alarmists who will raise the specter of illegal investment schemes. Let me tell you, those schemes already exist, they always have, they always will. We have the authority to prosecute those schemes and those schemers, and we should to the fullest extent of the law. In fact, the Department of Financial Institutions does a great job, and they will continue to do so. The changes I will propose will not inhibit their ability to enforce the law. Nor does this concern change the fact that we must make it easier to invest in Wisconsin's future.

I would like to share with you some ideas that will make Wisconsin a better place to invest.

- ◇ Increase from \$30 million to \$60 million the available investment tax credits for Angel Investors
- ◇ Increase from \$3 million to \$6 million the annual allocation of investment tax credits
- ◆ Permit unused Venture Capital Investment Tax Credits to be reallocated to Angel Investment Tax Credits in the succeeding year

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- ◇ likewise, we should permit unused Angel Investment Tax Credits to be reallocated to Venture Capital Investment Tax Credits in the succeeding year
- ◇ the market should determine where the credits are used, not statutory limitations

- ◆ Increase the capital gains exemption to 100% for farmers, small business owners and investors who invest a long term capital gain in a Wisconsin business or investment
 - ◇ this will give those who have long term capital gains the incentive to repatriate those gains as investments in Wisconsin businesses
 - ◇ it will provide additional capital for existing and startup Wisconsin businesses
 - ◇ it will let this legislature send the policy statement that Wisconsin wants investment because investment creates jobs

- ◆ Under sec. 551.23(10), Wis. Stats., increase to 100 (from the current 25) the number of security holders permitted under the exemption
 - ◇ these limits increase risk by concentrating it in fewer investors

- ◆ Under sec. 551.23(11), Wis. Stats., increase to 300 (from the current

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25) the number of offers permitted under the exemption.

- ◇ these limits prevent effective networking essential to entrepreneurial success
- ◇ Eliminate a prohibition on advertising of offerings under the exemption
- ◆ Increase to \$50 million (from the current \$5 million) the maximum offering amount that can be raised from investors under the existing Wisconsin-Issuer-Registration-Exemption-by-Filing provision in DFI-Sec 2.028.
 - ◇ this increase would acknowledge the increased cost of starting a new business
- ✓ ◆ Repeal the Shareholder Wage Lien statute
 - ◆ this statute puts investors in “double jeopardy”
 - ◇ not only can they lose everything they have invested in a company
 - ◇ they can also be responsible for unpaid wages
 - ◇ why are investors to blame?
 - ◇ this statute create a unique investor risk, it gives a perverse new

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- meaning to the term “risk capital”
- ◇ puts Wisconsin companies at a disadvantage when attempting to raise equity investments
- ◇ investors will look elsewhere

These changes individually may appear are incremental improvements to the Wisconsin investment climate, taken together they represent a substantial change. I will not claim that these are the only ideas that exist to improve the investment climate, they may not be the best ideas, but I believe they are a starting point, and that is what we need.

Thank you for your attention. I would be happy to answer any questions that you may have.



SB 290?
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Date?

JOSEPH P. HILDEBRANDT

PRESENTATION TO THE COMMITTEE ON JOB CREATION, ECONOMIC
DEVELOPMENT AND CONSUMER AFFAIRS
SENATOR TED KANAVAS, CHAIRPERSON

Thank you for the opportunity to testify to your Committee today.

I am Joe Hildebrandt, a partner of the law firm of Foley & Lardner LLP, Co-Founder and Chair of its Private Equity and Venture Capital Group. Let me however, give the standard disclaimer that this presentation and my suggestions are strictly my own and were not discussed with or are necessarily the views or positions of the law firm or any of its clients.

I have been involved for over 30 years in working with the State on various Securities, Corporate and Secretary of State improvement committees and have made suggestions and testified at various legislative hearings in my own capacity and as Chair of the Business Law Section of the State Bar Association. I was co-organizer of the two Governor's Summits on Capital and in connection with such Summits, prepared separate White Papers on proposals for the State to encourage emerging growth companies and enhance capital investment in Wisconsin, leading to job creation. Certain provisions in such White Papers provided the initial basis for Act 255.

Based on such provisions and my presentations at such Summits, Senator Kanavas took the lead to invite me to meet with him and discuss how legislation could incorporate some of such provisions, which ultimately was forged into place as Act 255 under Senator Kanavas's leadership.

Act 255 was a wonderful start to help incentivise capital investment and growth in emerging Wisconsin companies and already we are beginning to see the benefits of it with the increased funding of start-up technology companies that otherwise might not have been funded, leading to the creation of new high paying jobs. Let me thank Senator Kanavas, the Committee, the entire legislature and the Governor, for Act 255 and the progress to date.

But it is only a start.... As a State, we need to do more. As a State behind most states in new company formation, in new technology job creation, and certainly behind in angel and venture capital fuel to ignite such new companies and jobs, we need to do more.

Let me give some suggestions as to how to move forward in growth company and job creation. [I have had an opportunity to discuss certain proposals with Terry Grosenheider and the first 9 proposals below are consistent with those in his presentation.]

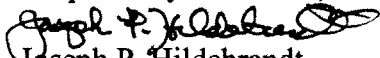
1. Increase from \$30 million to \$60 million the available investment tax credits for Angel investors.
2. Increase from \$3 million to \$6 million the annual allocation of investment tax credits for Angel investors.

3. Permit unused Venture Capital Investment Tax Credits to be reallocated to Angel Investment Tax Credits in succeeding years.
4. Increase the capital gains exemption to 100% for persons who invest a long term capital gain in a Wisconsin business.
5. Increase the number of security holders from 25 to 100 under the sec. 551.23(10) exemption.
6. Increase the number of security offers from 25 to 300 under the sec. 551.23(11) exemption, or under such exemption permit sales to 100 security holders.
7. Eliminate all prohibitions on advertising of offerings for all exemptions, assuming the advertising is filed simultaneously with its use and is subject to the anti-fraud provisions.
8. Increase the amount of capital that can be raised under sec 2.028 from \$5 million to \$20 million or more.
9. Repeal the Shareholder Wage lien statute.
10. Amend Act 255 to expand "Qualified New Business Ventures" by increasing the number of permissible employees from 100 to 200, the permissible years in existence from 7 to 10, and the amount of prior raised capital from \$5 to \$10 million.
11. Amend Act 255 to permit tax credits for follow-on investments in addition to initial investments by the same person.
12. Amend Act 255 to permit angel tax credits for angel investors, whether individually, through a network, or through a pass through entity (e.g., LLC or limited partnership), and whether investing through the entity for a single "Qualified New Business Venture" or more than one.
13. Defer Wisconsin income tax on investment gains if reinvested in Wisconsin businesses.
14. Facilitate the raising of venture capital by providing a tax credit to broker-dealers of 10% of the first \$500,000 raised in an offering of a Qualified New Business Venture in any 12 month period.
15. Permit any finders to be able to receive a fee for finding investors of up to \$2 million in a 12 month period under Wisconsin exemptions without a requirement of being licensed.
16. Create a separate state-sponsored seed capital fund with public and private contributions.

I have additional proposals from my prior White Papers and other new concepts to help raise capital for Wisconsin growth companies and help with high paying job creation, but I believe the above suggestions would be sufficient to take Wisconsin to the next level at this time.

Thank you for the opportunity to make these suggested proposals. I would be happy to answer any questions or go into more detail on any one of them.

Respectfully submitted,


Joseph P. Hildebrandt