



August 19, 2019

Senator Howard Marklein, Chair
Committee on Agriculture, Revenue and Financial Institutions
8 South, State Capitol
PO Box 7882
Madison, WI 53707-7882

Dear Senator Marklein,

Western National Mutual is an Edina, Minnesota based insurance company, that writes a significant portion of our premium in the state of Wisconsin. After learning about Wisconsin's Qualified New Business Venture program and the availability of tax credits for an out-of-state insurance company, we began looking at opportunities in Wisconsin, and made an investment in Madison-based Venture Investors.

Venture Investors had organized their fund to allow special allocation of the credits among the partners. They provided documentation from the former Secretary of the Department of Revenue acknowledging the interpretation that the credits were earned at the fund level.

In 2018, during a review by an Insurance Financial Examiner from the Wisconsin Office of the Commissioner of Insurance, we were denied the ability to use the credits that had been allocated to us under the rules that were in force at the time of our investment. The Examiner noted that the statutory language governing the use of tax credits by insurance companies was different than the other sections of the tax code and that they had to assume that this was intentional on the part of the legislature, something that couldn't be altered by the rules.

From our perspective, this interpretation undermines the incentive the program offered to induce us to invest in Wisconsin. It makes it difficult for us to consider similar investments in Wisconsin in the future unless this section of the statutes is amended and brought into parity with the other sections of the tax code where the credits can be utilized.

Looking at the history of the legislation, we do not believe that the current interpretation is consistent with the legislative intent. We encourage you to pass Senate Bill 208 to restore parity to the participants in the program

Sincerely,

Jon Sticha
Vice President Investments



SHANNON ZIMMERMAN

STATE REPRESENTATIVE • 30th ASSEMBLY DISTRICT

Good Morning Chairman Marklein and Committee Members,

As an entrepreneur myself, Senate Bill 208 is something I am excited to talk about. While the bill itself is technical, the results will be more money for startups in Wisconsin, which means new industries and new opportunities for our citizens.

I would like to thank the Wisconsin Technology Council for bringing this to our attention, especially Tom Still, who has been a tireless advocate on these issues. I would also like to thank Senator Marklein for once again helping me advocate for entrepreneurs, and to Representative Fields for bringing his enthusiasm and insight to these issues. And of course, a big thank you to Senator Taylor as well.

SB 208 is not substantially changing our law, but rather fixing an unintended consequence of two laws passing simultaneously. The Qualified New Business Venture program encourages entrepreneurship. It does this by lowering the daunting financial barriers of starting your own business through the form of tax credits. If you are not familiar with this world, one way many of these businesses start is through venture capital funds. These investors take a financial risk by investing in new companies, and in return the credits can be earned at the fund level, rather than the individual company.

The ability to earn at the fund level was common practice from 2005 when the credits started, and was codified into the statutes in a 2009 update. Allowing the tax credits to be applied in this way allows the fund to spread the financial benefits to all of its investors, and further encourages money to go to the exciting and innovating businesses of tomorrow.

In the same 2009 session, the Qualified New Business Venture program was seen as so successful, that it was expanded to allow insurance companies to also be part of these funds and gain these credits. However, the language used to include the insurance companies was the original 2005 language, not the updated 2009 language. This led the Office of the Wisconsin Commissioner of Insurance in 2018 to interpret the difference in statutes as intentional, thereby changing the rules for insurance investment.

This means **investment funds are still earning the credits, but are unable to offer the benefits to the insurance companies who generate the credits.** SB 208 simply copies the language for the other startup tax credits (as currently seen in the other sections of the statutes) so we continue to incentivize insurance companies, both inside and outside the state, to invest in Wisconsin startups, bettering our business environment.

Finally, I want to note the fiscal estimate from the Wisconsin Economic Development Corporation showing **there will be no fiscal impact from this bill**, and in fact this may even decrease administrative costs. Again, this bill is about fixing an oversight and returning parity to investors so that dollars continue to flow into Wisconsin startups.

Thank you very much for your time and attention, and I would be happy to take any questions.

August 20, 2019

TO: Senate Committee on Agriculture, Revenue and Financial Institutions
MEMBERS: Sens. Marklein, Petrowski, Testin, Jacque, Bernier, Smith, Ringhand, Risser and Larson
FROM: Tom Still, president, Wisconsin Technology Council
RE: Senate Bill 208

Thank you for taking the time to hear from me today regarding Senate Bill 208, which is a seemingly technical but nonetheless important piece of legislation.

The bill aims to clarify Wisconsin's successful Act 255 investor tax credit law by matching language pertaining to how the credits can be used, especially by certain insurance companies that invest in young companies.

Act 255 permits a taxpayer to apply the tax credit against several types of tax liabilities. When this bipartisan law took effect in 2005, it was corporate income taxes, individual income taxes, and trust income taxes. These are three different sections of the statutes. In each section there is identical language about how the credits can be used.

In 2009, the Legislature added gross premium taxes, which are a tax on out-of-state insurance companies operating in the state. It works like a sales tax on the policies. The goal of expanding the credit was to create an *incentive* for out-of-state insurance companies to invest in Wisconsin companies, either directly or by investing in venture capital funds.

Because of some unintended "version controls" in later amendments to the law, the section allowing credits to be applied to gross premium taxes was inadvertently left out. I will leave it to John Neis, managing director of Venture Investors LLC – the state's oldest and largest venture capital fund – to provide more detail and to explain the fix, which SB 208 embodies.

Passage of SB 208 will not have a fiscal effect. It will neither increase nor decrease the amount of credits available.

Rather, passage will remove a disincentive for out-of-state insurance companies to invest more in Wisconsin. That's where I want to spend a little more time to explain why that is important.

Despite progress in recent years, Wisconsin still has a shortage of venture capital. Our state has nearly 2 percent of the U.S. population and GNP, but only 0.27 percent of the nation's venture capital assets under management.

We need more in-state venture capital firms – John would welcome the competition, which he would more accurately describe as co-investors. We also need more out-of-state investors in Wisconsin companies.

Net investment into Wisconsin from outside the state is a good thing. California's success is in part because their VC industry was a *net importer* of capital from around the world. They couldn't have done it with only capital from inside the state. We are a *net exporter* of capital. We need to broaden the participation here and attract others from the outside.

Attracting capital from insurance companies is particularly attractive, and timely, because of a boom in VC and corporate VC investment in “insure-tech” and “fintech.” Both are ripe areas for innovation in Wisconsin and where, as a Tech Council, we see more young companies.

Venture funding for insurance and insure-tech companies hit all-time highs in 2018, according to Crunchbase data, with both global and U.S. totals reaching record levels. A space that once attracted a few hundred million in venture investment is now in the multiple billions.

Nationwide, insurance and insure-tech startups raised just over \$2.5 billion in 2018, more than double 2017 levels.

The trend of incumbent insurance companies launching or scaling up venture arms started a few years ago, and it's been accelerating. It's part of the larger trend of corporate venture capital.

Today, there are about 30 insurance companies active in the asset class, including American Family Insurance, Northwestern Mutual and CUNA Mutual in

Wisconsin. Those other out-of-state firms are potential investors in emerging Wisconsin companies, as well.

Some of the big insurers are increasing their investment pools. This year, German insurance giant Allianz increased the size of its corporate venture capital arm, Allianz X, to around \$1.1 billion, more than double its initial size. American Family recently increased its fund by about \$200 million.

In short, there is more “dry powder” to invest in the sector – and we should welcome it.

The market is on its way up and Wisconsin could seize an important advantage by making sure its statutes align as intended, without adding any burden to the taxpayer.

We urge you to pass SB 208 and help to better position Wisconsin to attract investment from outside the state to help grow young companies here.

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HOWARD MARKLEIN

STATE SENATOR • 17TH SENATE DISTRICT

August 20, 2019

Senate Committee on Agriculture, Revenue & Financial Institutions Testimony on Senate Bill 208

Good Morning! Thank you committee members for hearing Senate Bill 208 (SB 208), which makes changes to the statutes for the Early Stage Seed Investment credit. The credit was originally created by 2003 Wisconsin Act 255, and took effect on January 1, 2005.

SB 208 modifies parts of the state tax code by allowing a partnership, limited liability company, or tax-option corporation to allocate the investment tax credit at the entity level rather than the claimant level. This aligns the tax code for investments made into a Qualified New Business Venture by an insurance company with other types of eligible investors.

The purpose of the credit, when it was originally created, was to encourage investment in venture capital funds that help start-up companies begin or expand operations. Investment in these new companies has a higher degree of risk, and the credits are intended to mitigate some of the risk for investors. Under the original bill, the credits could be applied to corporate income taxes, individual income taxes or trust income taxes.

Over the years, amendments were made to the original language to improve the effectiveness of the credit. In the 2009 session there were two amendments circulating at the same time, but they were adopted separately. One allowed the credits to be applied to the premium and gross investment taxes, which gave insurance companies an opportunity to make these investments. The other change allowed a special allocation of the credits at the entity level, rather than for the individual investors.

The special allocation language was drafted off of the original language that took effect in 2005, so it did not include the premium and gross investment taxes that were added in 2009. This has the negative effect of making an out-of-state insurance company that wants to invest in a Wisconsin based venture capital fund ineligible for the credits.

This proposal has bipartisan support and the fiscal estimate prepared by WEDC indicated that there is no state fiscal effect.

I would like to thank our Assembly colleagues Representatives Zimmerman and Fields for working with me on this legislation, and Sen. Taylor has been supportive as well.

Thank you again for hearing SB 208, and your timely action on this proposal.

Wisconsin Committee on Agriculture, Revenue and Financial Institutions
Testimony on Senate Bill 208 by John Neis, Managing Director of Venture Investors LLC
August 20, 2019

Thank you, Chairman Marklein and members of the Committee for the opportunity to testify. I am here today representing the interests of Venture Investors LLC, Wisconsin's oldest and largest venture capital firm, and the manager of several Qualified Funds that have participated in the Qualified New Ventures Program since the program's inception.

When the Qualified New Ventures Program was first introduced by Senator Ted Kanavas, it was a bold, innovative idea to encourage investors to take more risk and invest in young Wisconsin companies. It triggered real growth in entrepreneurial activity and investment in Wisconsin. However, that original law contained numerous constraints that created practical limitations on its effectiveness. It only covered the first \$4 million investment, of which no more than \$1 million could come from angels and no more than \$2 million could come from a single venture capital fund. The credits could not be sold, and the taxes against which the credits could be applied were limited. Over the years, several amendments were needed to transform it into the effective legislation it is today.

Among the early concerns was how the tax credits could be treated within a venture capital partnership. When the legislation originally passed, we stressed the importance of the credits being earned at the fund level, and that a fund be allowed to specially allocate the credits within the fund. In a fund that includes tax exempt investors like pension funds or foundations, the ability to specially allocate was important to enable a fund to give the credits to those who can use them, and then offsetting allocations on income to those who can't, thereby equalizing the benefit to all the investors on a fund. Without that ability, the funds have a fiduciary duty to ignore the tax credits in their investment decisions because they are required to treat all equally and some benefit while others would not. This would obviously thwart the legislative intent of the credits, which was to create an incentive for investors to favor Wisconsin companies.

The Department of Commerce governed rule making at that time, and the Department of Revenue weighed in to acknowledge the importance of allowing this. However, it was suggested that it would be preferable to make a statutory amendment to provide investors confidence that the rules would not change during the ten year life of their investment commitment, potentially eliminating the incentive that attracted their investment. The original drafts of that bill targeted the three sections in the tax statutes where the credits could be applied. In 2010, a bill was passed that made this statutory language in Wis. Stat. sections 71.07(5b), 71.28(5b), and 71.47(5b), where it says:

b) Filing claims.

1. For taxable years beginning after December 31, 2004, subject to the limitations provided under this subsection and s. 238.15 or s. 560.205, 2009 stats., and except as provided in subd. 2., a claimant may claim as a credit against the tax imposed under s. 71.23, up to the amount of those taxes, 25 percent of the claimant's investment paid to a fund manager that the fund manager invests in a business certified under s. 238.15 (1) or s. 560.205 (1), 2009 stats.
2. In the case of a partnership, limited liability company, or tax-option corporation, the computation of the 25 percent limitation under subd. 1. shall be determined at the entity level rather than the claimant level and may be allocated among the claimants who make investments in the manner set forth in the entity's organizational documents. The entity shall provide to the department of

revenue and to the department of commerce or the Wisconsin Economic Development Corporation the names and tax identification numbers of the claimants, the amounts of the credits allocated to the claimants, and the computation of the allocations.

- (c) Limitations.** 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.

Among the other amendments being considered around the same time, there was an expansion of the types of taxes that could be offset with the credits to try to attract investment from out-of-state insurance companies who pay gross premium taxes under section 76.638. Insurance companies are a major investor in the venture capital asset class, and by amending this section it would encourage them to invest in Wisconsin. The original draft of that language matched the original language in these other sections where it simply says:

- (2) FILING CLAIMS.** For taxable years beginning after December 31, 2008, subject to the limitations provided under this subsection and s. 238.15 or s. 560.205, 2009 stats., an insurer may claim as a credit against the fees imposed under s. 76.60, 76.63, 76.65, 76.66, or 76.67, 25 percent of the insurer's investment paid to a fund manager that the fund manager invests in a business certified under s. 238.15 or s. 560.205 (1), 2009 stats.

Insurance companies' commitment to invest in Wisconsin funds, relying on the ability to specially allocate the credits as had been adopted in the rules. Unfortunately, the draft amendments weren't adjusted to reflect the newly adopted language, resulting in a lack of parity in the sections. We believe this was a "version control" drafting error that was not the legislative intent. In fact, it seems nonsensical that this would be the intent because it completely undermines the incentive for out-of-state insurance companies to invest in the state, thereby removing the legislative intent. It makes the expansion to include 76.638 a meaningless exercise.

The Office of the Commissioner of Insurance routinely sends an Insurance Financial Examiner to review insurance companies in Wisconsin. Not knowing the detail of the legislative history or intent, they looked at the legislation at face value, noting that the section applying to insurance companies was uniquely differentiated from the other three sections, and could only conclude that the difference was intentional. As a result, they began to deny the ability of the insurance companies to receive specially allocated credits in a manner that was described in the organizational documents of the fund. It diminished their return and again created a fiduciary problem for the fund manager because investors were no longer able to benefit equally from the program. We have been told by one insurer that they are unlikely to invest again unless this is fixed because the incentive that attracted them has effectively been removed.

We believe that the proposed bill is consistent with the original legislative intent. It restores parity to each section of the statutes where the credit can be applied. It has no fiscal impact to the budget. As a result, I strongly encourage you to pass the legislation.