Senate Fiscal Agency
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BILL ANALYSIS

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House Bill 4195 (Substitute S-1 as reported)
House Bill 4196 (Substitute S-1 as reported)
House Bill 4365 (Substitute H-1 as reported without amendment)
Sponsor: Representative Al Pscholka (H.B. 4195)
Representative Michael D. McCready (H.B. 4196)
Representative Brandt Iden (H.B. 4365)
House Committee: Commerce and Trade
Senate Committee: Economic Development and International Investment

Date Completed: 10-27-15

RATIONALE

A key element in fostering economic development and promoting job creation is the availability of capital investment in early-stage small businesses. Venture capital firms (businesses that offer financial and strategic planning resources to young companies) often are the source of this type of investment. The Michigan Early Stage Venture Investment Act, enacted in 2003 and amended in 2005, created the Michigan Early Stage Venture Investment Corporation to provide a means for Michigan businesses to receive venture capital from investors. At the time, Michigan was in a decade-long recession, jobs and respectable wages were scarce, and venture capital was limited.

There is concern, however, that the program has not been very successful in retaining and supporting Michigan businesses. After reviewing the program, some people believe that it is, overall, detrimental to the State budget. To address these concerns, some have suggested that the program should be limited and terminated before it is scheduled to expire on January 1, 2054.

CONTENT

House Bill 4195 (S-1) would amend the Michigan Early Stage Venture Investment Act to prohibit the Michigan Early Stage Venture Investment Corporation from entering into any new agreements with investors, creating any new Michigan Early Stage Venture Investment Funds, or making any new commitments to contribute capital to a venture capital company.

The Treasury Department would be prohibited from approving any new tax voucher certificates after the bill's effective date. The total allowable amount of all tax voucher certificates issued under the Act would be reduced from $600.0 million to $450.0 million.

The bill would require the Corporation's annual report to be provided to the chairpersons of the House and Senate Appropriations Committees and be made available on the internet. It also would add several required items to the report.

The bill also would require the Corporation's articles of incorporation to include a provision that, upon dissolution, the first $140.0 million of the Corporation's property would go to the General Fund and the remainder to the 21st Century Jobs Trust Fund.

House Bill 4196 (S-1) would amend the Michigan Early Stage Venture Investment Act to change the expiration date of the Michigan Early Stage Venture Investment Fund from January 1, 2054, to January 1, 2030, and require that the first $140.0 million of the

money in the Fund go to the General Fund and the remainder to the 21st Century Jobs Trust Fund.

<u>House Bill 4365 (H-1)</u> **would amend the Michigan Business Tax Act to change from $600.0 million to $450.0 million the total allowable amount of voucher certificates approved under the Michigan Early Stage Venture Investment Act.**

The three bills are tie-barred to each other.

<u>House Bill 4195 (S-1)</u> is discussed in detail below.

The bill would prohibit the Michigan Early Stage Venture Investment Corporation from entering into any new agreements with investors after the bill's effective date. The Corporation would be allowed to modify an existing agreement with an investor as long as no additional principal was borrowed from the investor and the amount of total tax vouchers was not increased above $450.0 million. (A tax voucher is a certificate that a taxpayer can remit in lieu of a tax payment or a portion of a tax payment.) The Corporation also would be allowed to modify an existing agreement with an investor from which it had received a loan or line of credit and spend money to modify that agreement as long as it did not spend more than $500,000 without the consent of the State Budget Director and it notified the State Budget Office and the chairpersons of the House and Senate Appropriations Committees within 30 days of the finalization of the modification.

The bill would prohibit the Corporation from creating a Michigan Early Stage Venture Investment Fund or making any new commitments to contribute capital to a venture capital company after the bill's effective date. A fund could modify an existing agreement or investment with a venture capital company as long as no additional money was committed to the company.

The Act requires the articles of the Michigan Early Stage Venture Investment Corporation to provide that, upon dissolution of the Corporation, the property remaining after providing for its debts and obligations must be distributed to a governmental unit or a tax-exempt organization as designated by its board of directors. If the board fails to designate an organization, the property must pass to the State. The bill instead would require the articles to provide that the first $140.0 million would go to the General Fund and any remaining amount would go to the 21st Century Jobs Trust Fund.

The Act requires the Michigan Early Stage Venture Investment Corporation to publish an annual report detailing its activities, the economic impact of its investment plan on the State, and other information. The bill also would require the report to be made available on the internet and include the following items:

- Return through the fiscal year from investments made by each Michigan Early Stage Venture Investment Fund in venture capital companies.
- The number of seed or early stage businesses that had been funded by venture capital companies.
- The aggregate net distributions made to each fund by the venture capital companies that had entered into agreements with each fund through the end of the fiscal year and since the inception of each fund.
- The total amount invested by each fund in venture capital companies.
- Any upcoming use of tax vouchers that was certain and the timing of that use.
- An estimate of the potential use of tax vouchers over the five-year period following the end of the fiscal year.

MCL 125.2237 et al. (H.B. 4195)
125.2261 (H.B. 4196)
208.1419 (H.B. 4365)

BACKGROUND

The Michigan Early Stage Venture Investment Act, which created the Michigan Early Stage Venture Investment Corporation, was enacted in 2003 to "promote the economic health" of Michigan "by assisting in the creation of new jobs, new businesses, and new industries". The Corporation created a fund-of-funds (the Venture Michigan Fund, or VMF) that would invest money with private venture capital funds that, in turn, would invest in Michigan-based early stage companies. Two funds were created under the VMF: the Venture Michigan Fund I, Limited Partnership (VMF I) and the Venture Michigan Fund II, Limited Partnership (VMF II).

The Venture Michigan Fund borrowed $450.0 million to provide investment capital for VMF I and VMF II, and business tax credits were used to collateralize the loans. The credits were subsequently converted by statute to transferable tax vouchers, which may be sold to Michigan taxpayers. Those taxpayers may remit the vouchers to satisfy their withholding liabilities under the Michigan Income Tax Act.

As approved by the State Treasurer, $450.0 million in vouchers has been issued (out of the $600.0 million currently authorized by statute). The vouchers essentially are held in escrow, and will be presented to the lenders as necessary to make loan repayments to the extent that the return on investments in the venture capital funds is not sufficient. At present, vouchers worth $140.0 million (out of the $450.0 million issued) are scheduled to be presented to the lenders as follows: $25.0 million in June 2015, $25.0 in October 2015, $50.0 million later in fiscal year 2015-16, and $40.0 million in fiscal year 2016-17.

(For an in-depth discussion of the Michigan Early Stage Venture Investment Corporation and the related issues, please see the Senate Fiscal Agency's *State Notes* article, "Michigan Early Stage Venture Capital Tax Vouchers", winter 2015.[1])

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

To date, $450.0 million in tax vouchers has been issued to provide collateral for the loans made to the Michigan Venture Fund. Although $140.0 million of those vouchers has been or will be presented to the lenders at intervals between June 2015 and the end of fiscal year 2016-17, it is not known when the lenders will sell the vouchers to taxpayers, what proceeds the lenders will receive for them, when the taxpayers purchasing the vouchers will use them to satisfy a tax obligation, or when the remainder of the vouchers that have been issued will be presented to the lenders. What is known is that the negative impact on the State's budget will be sizeable, but it is not certain when that impact will occur. The State also does not know the extent to which investments in early-stage businesses will pay off, or how many businesses that received investments remain in Michigan. Overall, the program does not appear to have been very successful in supporting Michigan start-ups or stimulating the economy, at least when compared to its costs.

Therefore, to prevent the State from incurring additional liability, the bills would prohibit the VMF from issuing more tax vouchers, and would terminate the program 14 years ahead of the current schedule. Also, it is expected that the additional reporting requirements would help the State to estimate future profits and liabilities.

Response: As of November 2014, the two VMF programs had invested $155.0 million in 42 Michigan early-stage companies. Reportedly, these 42 companies have more than 1,000 employees and employment at these firms has increased by approximately 59.5% since they began receiving capital from the VMF program.

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[1] The article can be found at this site:
http://www.senate.michigan.gov/sfa/Publications/Notes/2015Notes/NotesWin15dz.pdf

In addition, the number of venture capital firms headquartered in Michigan increased from just a few in 2003 to 16 in 2009 and 23 in 2013, while the number of venture capital professionals employed at these firms almost doubled in five years, rising from 44 in 2009 to 81 in 2013, according to the Michigan Venture Capital Association (MVCA). Additionally, the MVCA reports that 51 companies in Michigan received more than $204.0 million from Michigan venture capital firms in 2014, an increase of 89% over the previous five years.

Michigan Venture Capital Association studies also have shown that for every dollar that has been invested in a Michigan start-up company by a Michigan-based venture capital firm, there is an additional $2.90 of investment from outside of Michigan. These dollars are considered to be returning to Michigan. In addition, the venture capital community and the Michigan Venture Capital Association report that the follow-up funding for the start-ups in Michigan is estimated to be around $1.3 billion over the next five years.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bills would effectively increase State revenue by an unknown amount by: 1) reducing the potential number of tax vouchers that may be redeemed against State tax liabilities, and 2) requiring net returns from affected investments to be deposited into the General Fund. While $450.0 million of tax vouchers has already been issued under the Act, current law allows as much as $600.0 million in vouchers to be issued. The bills would limit that exposure to the $450.0 million already issued, effectively preventing a potential revenue reduction of $150.0 million.

The bills also would direct net returns from affected investments to the General Fund, which would increase General Fund revenue by an unknown amount that would depend on the performance of the underlying investments. Because the bills also would accelerate when the Michigan Early Stage Venture Investment Fund will expire, those provisions could potentially reduce the return that might be earned if the investments are held for a longer period of time. The magnitude of any change in return from accelerating the expiration date is unknown.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.