Ohio House of Representatives

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Sponsor Testimony for House Bill 174
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House Economic and Workforce Development Committee

Chairman Edwards, Vice Chair Powell, Ranking Member Upchurch and members of the Economic and Workforce Development Committee, thank you for allowing us the chance to provide testimony on House Bill 174, a bill that authorizes an income tax deduction for capital gains received by investors of Ohio-based venture capital firms.

Our goal in introducing HB 174 is to help level the playing field and encourage economic development in the state. The pandemic has provided us with a unique window of opportunity to entice the venture capital firms who are looking to leave their high-tax states to set up shop in Ohio, as well as the opportunity to develop our entrepreneurs and expand early-stage investments. We need to compete with the other 22 states that offer tax credits to venture capital firms to encourage economic expansion. Ohio is always in competition with the 49 other states to attract and generate economic development and high paying jobs. Some states offer other financial incentives in addition to their venture capital credits, most notably are those that leverage their status as zero income tax states to attract development. One way we can compete is with HB 174 to provide capital gains tax deductions to Ohio-based venture capital firms.

Ohio is no stranger to startups and innovation and was once a world leader. In the late 19th and early 20th century Ohio was home to technological and business innovation leaders like Thomas Edison, John D. Rockefeller, and of course the Wright Brothers. However, today our startups are at a competitive disadvantage when it comes to the all-important access to venture capital, which happens at the most critical stage of business development. Venture capital has historically been dominated by investment activity in California, Massachusetts and New York. From 2004 to 2019, these coastal states have managed approximately 77.45% of assets under management and raised 80% of the total US venture capital dollars raised. The same is true with tech startups. In an August Cleveland.com article it was noted that in a Midwest-only ranking of tech startups, the top six cities in the Midwest are Chicago, Minneapolis, Pittsburgh, Indianapolis, St. Louis and Ann Arbor. Yes, Ann Arbor ranks higher than any Ohio city. And while Columbus is on the list at number 7, Cincinnati dropped to number 10 and Cleveland has fallen off the list completely. Madison and Detroit are the two other cities to round out the top ten. Many startups are in college towns, hence the placement of Ann Arbor and Madison on the list. And while Ohio has an abundance of colleges and universities spread throughout the state and a reputation for a strong work ethic, we need more to compete and to leverage the talent and innovation that we have in in all four corners of our state.

Recently we have seen signs of growth in startups and venture capital rankings, but the past year has highlighted the golden opportunity we have to incentivizing the relocation of even more resources to our state and to enhance our economic development by offering deductions to capital gains. HB 174 will accomplish just that by authorizing an income tax deduction for capital gains received by investors in certain Ohio-based venture capital operating companies.

To qualify for the deduction a venture capital company must be certified by the Director of Development Services as an Ohio-based venture capital operating company (VCOC) with at least 50% of their assets in operating companies or derivative investments in which the fund has direct contractual management rights, and they must exercise management rights with respect to at least one operating company. Additionally, the firm must manage at least $50 million in capital commitments, and at least two-thirds of its managing and general partners are required to be residents of Ohio.

The payoff can be substantial. For every $1 billion in venture capital invested in Ohio, $975.6 million is generated in state income tax revenue, creating at least 560 high-wage jobs and $124 million in annual payroll over a 10-year period. A venture capital operating company also brings a supply-chain effect of follow-on funding and relocation of start-ups to our state. Unlike a credit, there is no cost to Ohio unless the venture capital firm is successful and generates capital gains. The deduction will equal 100% of the capital gains attributable to the certified Ohio venture capital firm's investment in Ohio and 50% of its gains attributable to other investments.

Venture capital investors have become proven job creators – funding companies right here in Ohio or moving their investments within our state's borders to create high paying jobs in newly emerging industries like digital, insurtech, and bioscience. We have a unique opportunity with HB 174 to incentivize success, grow our entrepreneurial talent, and level the playing field for competition in both the venture capital world and the business startup world.