Appeared in Crain's Chicago Business digital edition, June 8, 2017

Want to kill startups in Illinois? Pass this 'privilege' tax.

Over the past decade, Chicago and Illinois have made enormous strides in attracting venture capital and private equity investors to set up shop in the state and fund entrepreneurs and promising private companies.

Pitchbook reports that Illinois ranked first in money invested in local portfolio companies by private equity firms. **Chicago also ranked highest** among U.S. cities in generating the best investment returns from private companies that went public or were acquired over the decade ended in 2015. Further, Chicago ranks No. 7 in the country on its list of "**U.S. Venture Capital Ecosystems**," the only Midwest city in the top 12.

It is ironic, then, that just as Illinois' venture ecosystem has reached liftoff, the Illinois Legislature seems determined to undo this progress and drive away the private company investors who have helped finance hundreds of new and expanding companies in our state. The Illinois Senate in late May **passed SB 1719**, which would impose a 20 percent tax on capital gains earned by investors in private companies. The House is expected to **consider corollary HB 3393 bill in the overtime session**. Chief sponsors of the bill—Sen. Daniel Biss, D-Evanston, and Rep. Emanuel Chris Welch, D-Westchester—call it a "privilege" tax.

Let's look in simple terms at the business of investing in private companies. Imagine that you are adept at identifying a good company. Because of your experience and reputation, friends pool their money and ask you to invest in companies on their behalf. You spend five to 10 years finding great portfolio companies and management teams; help them to identify and generate new customers; and invest in improved operations in the belief that these companies at some unknown future date can be sold for more than you paid for them. Recognize, too, that while you are finding and nurturing these great companies, you may forego a salary.

But it's worth it because when all the companies are sold, you, as the general investor, will be in line for one-fifth of the increased value or "capital gain," created by your hard work and expertise. The remaining four-fifths of the capital gain is divvied up among your "friends" who pooled the money you invested. In the real world, these friends are limited partners—often pension funds and endowments that seek a greater return with private company investors than they can find in public markets.

Now here comes the state of Illinois using tax policy, which is generally designed to promote or discourage certain types of economic activity, telling you to fork over 20 percent of your hard-earned and highly uncertain capital gain for the "privilege" of doing business in Illinois. That's a tax policy that will drive private company investors right out of the state.

Never mind that it usually takes five to 10 years for a private company investment adviser to receive any capital gain from the sale of a portfolio company or investment. Or that a capital gain only occurs if the investment increases significantly in value—in part reflecting the investment adviser's expertise.

The Illinois Department of Revenue stated the obvious in **a fiscal note to the Senate bill**: "Due to the magnitude of the tax, this bill would elicit a strong behavioral response from would-be taxpayers. Taxpayers would be strongly incentivized to relocate the taxable activity so that it is beyond the reach of the state." The fiscal note also noted that the measure is probably unconstitutional.

There is a reason that no state levies a similar tax. Firms that fund private companies will simply move to more welcoming jurisdictions. Indiana and Wisconsin already are beckoning to Illinois-based investors in private companies.

Keeping in mind that investors in private companies already pay federal and Illinois income taxes, simply ask yourself: If you had the chance to base your business anywhere in the U.S., why would you, an innovative entrepreneur or interested investor, stay in Illinois? That's the cliff over which the short-sighted "privilege tax" threatens to take Illinois' now-successful private investing ecosystem.

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